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Communications and publicity by crowdfunding portals

Crowdfunding offerings under Section 4(a)(6) (Title III of the JOBS Act) are required to be made through intermediaries. These intermediaries may be broker-dealers or crowdfunding portals. A crowdfunding portal is a completely new type of regulated entity, whose business is limited to crowdfunding offerings. Portals can be viewed for many purposes as "limited purpose broker-dealers." They must be registered with both the Securities and Exchange Commission (SEC) and with FINRA, and both the SEC's Regulation Crowdfunding (Reg CF) and FINRA's Funding Portal Rules. Both these sets of rules restrict the type and content of communications that funding portals may make.

The statutory prohibition

Baked in to the definition of a "funding portal" in the JOBS Act is a requirement that the funding portal must not "solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal." This presented a problem to the SEC. The mere act of displaying information about offerings on a website is, under securities law, a solicitation of offers, so the SEC had to thread a delicate definitional needle in making it clear (as discussed below) that not only were such solicitations actually allowed, but that portals were allowed to solicit business for themselves. When reading these guidelines, bear in mind that the SEC has already stretched (in your favor) the statutory prohibition beyond the normal meaning of words, so if you want to push the regulatory envelope you are on your own.

The JOBS Act also bakes in to the definition of funding portal a prohibition on offering "investment advice or recommendations."

What is permitted

The SEC was faced with an interpretive challenge in regard to how to allow funding portals to advertise their own existence. The JOBS Act prohibits funding portals from offering investment advice or recommendations, or soliciting investors. Some commenters pointed out to the SEC that applied fully, these restrictions could even bar the funding portal from operating at all, because the mere existence of the portal could be seen as a solicitation. To prevent this outcome, the SEC adopted Rule 402(b)(9), which permits a funding portal to advertise its existence and identify one or more issuers or offerings on the portal, so long as that communication complies with the restriction that the portal may not offer investment advice. We should note that the definition of "investment advice" is very broad, and can encompass any recommendation with respect to a security, or assessing the comparative advantages of investments.

The portal advertising rules permit advertising by the portal to identify particular issuers or offerings based on objective criteria where the criteria are reasonably designed to highlight a "broad selection" of issuers offering securities. The objective criteria may include:

- The type of securities being offered;
- The geographic location of the issuer;
- The industry or business segment of the issuer;
- The number or amount of investments made;
- Progress in meeting the target or oversubscription amount;
- Minimum or maximum investment amount.

This is not an exclusive list, but the criteria must be reasonably designed to include a broad selection of issuers and offerings, so as not to recommend or implicitly endorse one issuer or offering over another, and must be applied consistently to all potential issuers or offerings. The portal can't be paid for this highlighting.

We believe that best practices would include an explanation as to why certain issuers or offerings are being included, by reference to the criteria (as discussed below, this is required if you highlight offerings on your website). If the criteria don't fit in a particular communication due to space constraints (Twitter, for example, or some Facebook ads), it's difficult to see how that communication could be used to present a "broad selection" of issuers in the first place. However, it may be possible to be creative with images in such media if character counts cause problems. Best practices include (a) saying why you are highlighting the issuers (the objective broad criteria) and (b) including a broad selection of issuers who fall into that category. The explanation of criteria can be as simple as "Here are details of all the companies who launched on SuperPortal this week."

We think it's a bad idea, by the way, to be constantly creating new objective criteria. While you will want to change your messaging from time to time in order to respond to market conditions, doing so on the fly will make it look like you are changing the criteria in order to highlight individual issuers. What do we mean by "constantly" in a market that is evolving on a daily basis? It's going to be a judgment call which will vary according to the portal's business, but daily changes would look suspicious while adjusting criteria on a quarterly basis seems reasonable.

Similar to the advertising rules, Rule 402(b)(2) of Regulation CF permits a funding portal to highlight particular issuers or offerings based on objective criteria where the criteria are reasonably designed to highlight a "broad selection" of issuers offering securities. When issuers or offerings are highlighted on the portal's website, the criteria must be specified. As discussed above, a simple statement as to the basis on which offerings are highlighted is enough.

It's important to note a couple of important principles that might help portals assess whether a particular communication is permitted or not:

- The purpose behind permitting communications by portals is to let them advertise the portals' existence and solicit potential investors to check them out, not to assist issuers on their sites in promoting the issuers' offerings.
- Issuers are not allowed to use (or permit) someone else to make communications on their behalf that they can't make themselves.

Standards of commercial honor and principles of trade

FINRA rules (FINRA Standards), specifically Funding Portal Rule 200 relate to the content of communications, whether they mention any issuers or not. FINRA requires that portals "shall observe high standards of commercial honor and just and equitable principles of trade."

FINRA also prohibits the effecting of any securities transaction by any manipulative, deceptive or other fraudulent device or contrivance. The FINRA Standards go further than the securities antifraud provisions that apply to anyone making securities transactions in also prohibiting the "aiding and abetting" of fraudulent transactions. This means portals may be liable for the misstatements of other persons in some circumstances, in addition to the liabilities imposed on portals by the JOBS Act and Reg CF. Specifically, FINRA identifies that funding portals are not liable for any communications prepared solely by an issuer, however, if the funding portal knows or has reason to know that such communication is false or misleading, the portal may be held liable if it adopts those communications in its own communications or on its site.

The FINRA Standards prohibit, in a portal communication:

- Any false, exaggerated, unwarranted, promissory or misleading statement or claim.
- Omission of any material fact or qualification if the omission, in context, would make the communication misleading.
- Any statement that FINRA endorses, indemnifies or guarantees the portal's business practices.
- Any prediction or projection of performance or implication that past performance will recur or any exaggerated or unwarranted claim, opinion, or forecast.

FINRA also requires that any portal communication be based on principles of fair dealing and good faith, and must be fair and balanced. A review of FINRA enforcement records reveals that this principle is most often violated in the context of an unsuitable recommendation. Because funding portals are prohibited from making recommendations, any communication that could be interpreted as a recommendation by an investor could be the basis for a violation of a portals duty of fair dealing and good faith.

Finally, FINRA rules require that any communication by the funding portal prominently disclose the name of the funding portal or the name under which it primarily conducts business.

What type of communications can we make?

Portals may use any form of advertising, including social media. The format of communications is not limited, and images and videos may be used. Images and videos are equally subject to the securities antifraud rules and to the FINRA Standards. So use images only of real products actually currently produced by the company (or in planning, so long as you clearly indicate that), actual employees hard at work, genuine workspace, etc. No cash registers, or images of dollar bills or graphics showing (or implying) increase in revenues or stock price. And don't use images you don't have the right to use! Don't use the SEC's logo anywhere.

Can we send out an email or tweet that only features one issuer?

When the SEC drafted its rules, it seems that the Staff were expecting a higher volume of Reg CF offerings than we are yet seeing. The "broad selection" rules imply that they were expecting there to be a large number of issuers that could be selected from. However, there are a significant number of portals with only a handful of issuers listed at any one time. And the rules do distinctly refer to "one or more" issuers, so a communication that refers to only one issuer is obviously acceptable under certain circumstances.

But don't play cute with the selection criteria. Provided you follow the guidelines above about treating

all companies who fit the criteria you have already established you'll be ok even with just one company so long as your criteria do not look like they were designed so that only one company meets them. So for example, your communication can feature all the issuers from Baltimore, or all the baked goods providers, or all the companies who launched today, or everyone selling revenue sharing bonds. But if you send out an email or tweet or post with respect to a company meeting the criteria "muffin shops in East Baltimore selling common stock that launched this morning" you have to expect that the SEC and FINRA are going to have questions.

Additionally, we've heard some questions along the lines of "What if, instead of having one communication with all eligible companies, we send out a batch of separate communications, all at the same time, collectively highlighting a broad selection of issuers?" This probably doesn't work. The SEC may focus on the fact that individual communications could be forwarded, reposted or retweeted separately, which looks like recommending individual issuers.

What you can say about an offering before it is launched

Nothing. Before the point at which an issuer files its Form C with the SEC, neither they nor you can make any "offers" of securities, either publicly or privately. Remember that the SEC interprets the term "offer" very broadly. So no meetings with potential investors, or giving out any information on forums which offer "sneak peeks" or "first looks" at the offering. No "coming soon." Any communication made prior to filing the Form C may be construed as an unregistered offer of securities made in violation of Section 5 of the Securities Act — a "Bad Act" that will prevent you from being able to be involved in Regulation CF offerings in the future.

We believe that the appropriate sequence of events at launch is (a) file the Form C, (b) "switch on" the company's profile page on the portal, and (c) make permitted communications about the offering. There is often a lag between filing the Form C and going live with the company's page on the portal. In the event the portal receives questions from the public or press in those circumstances, portal personnel could respond that the deal is coming soon.

Can we coordinate communications with issuers?

Issuers might ask portals to participate in a coordinated communications plan. For example, they might want the portal to follow up a non-terms communication that they make on a particular social media channel with a portal communication giving details of terms. That probably won't work. For a start, the portal is subject to the "broad selection" rules discussed above, and manipulating the "selection" to send out a communication that just happens to include the issuer in question seems pretty dubious, and could definitely be interpreted as a recommendation. Additionally, remember the principle set out above: issuers can't use portals to indirectly make communications that they can't make themselves.

Does the volume of communications matter?

Remember the principle that advertising is primarily supposed to promote the portal, not the issuers. We can't say whether there's a magic number at which the sheer volume of social media communications will look like you are recommending an issuer, but if the same issuer appears in multiple communications over a short period of time, questions may be raised. There's probably a natural limit to the number of communications the issuer can put out overall before the potential market becomes tired of hearing from it, in any case. It is probably best practice to establish the number of communications you will normally send out for each "objective criterion" (for example, upon launch,

upon meeting a funding goal, etc.) and to try to stick to that number.

Can we sponsor "launch parties"?

Launch parties aren't really a good idea. For a start, they are going to be subject to the "broad selection" rules, so you'll need to treat companies equally with respect to eligibility for a party. Are you going to fly geographically remote companies in? Also, holding a party for someone really does look like an implied endorsement. Do you hold parties for people you hate? There's also the issue of issuer compliance. What happens if the CEO starts forgetting the issuer communications rules after a couple of mojitos?

Can we subsidize the cost of the issuer's marketing operations?

Yes. You can offer companies incentives to list on your portal, and that includes paying for or subsidizing the cost of their PR or marketing firms or the company producing the company's video. You don't have to treat all issuers the same in this respect, so you can spend more on one company than another. You can coordinate with the company's PR company to share your expertise, and help develop the company's messaging, but bear in mind that these activities must be promoting the company, not the portal. All communications that they make are subject to the rules that apply to issuers under Reg CF, of course. Remind PR agencies to comply with Section 17(b) of the Securities Act if they send out communications under their own name. Bear in mind that if you are paying for communications, they may be attributed to you, so don't let the marketers make any statements that look like the portal is making any recommendations, such as "The company's offering is made on SuperPortal, which imposes strict diligence requirements to assure only good companies are posted."

Updates and communications to alert investors that important information is available on the platform

There's a difference between advertising and operational communications. If you are sending out emails to tell subscribing investors that something significant has happened to the company they have committed funds to, it's fine to send that email. But doing the same thing on social media ("Widget Company has changed the minimum size in its offering!") looks more like advertising than operational communications, so the "broad selection" rules apply.

In some cases, a portal will want to send out specific information about an issuer-specific event on its site, such as a webinar or live Q&A session. While the rules that apply to this situation are not completely clear, we have discussed with the SEC Staff how such communications should be treated, and it currently seems that such communications are best treated as being made on behalf of the issuer, since they are not technically portal advertising, and thus should be made in compliance with the issuer communications rules as a "non-terms" communication.

The analysis might be easier if the webinar were to feature a number of issuers or a number of webinars for different issuers, in which case the communication might amount to portal advertising, but we still recommend not including any terms of the offering.

Press releases and interviews

You can put out press releases that mention new offerings, subject to the FINRA Standards and the broad selection rules. Press interviews are a bit trickier. If you mention any issuers, mention several (take a notepad with you or write their names on your hand). If the interviewer asks questions about

any particular issuer, in your answer try to mention any companies that might be in the same categories ("Billy, glad you asked about MuffinTops, yes they are on our site along with BagelBites and Toastee.")

How communications by portals are different from communications by issuers

Issuers are subject to a completely different set of restrictions, derived from a different prohibition in the JOBS Act. The JOBS Act forbade issuers from "advertising the terms" of the offering they are making, except in limited "tombstone"-type communications. However, communications that do not mention the terms of the offering are less restricted. We published a comprehensive memo on the topic. Communications by portals are not subject to this terms/non-terms dichotomy. Portals may mention the terms of an offering, but must comply with the portal-specific rules set out in this memo.

How communications by portals are different from communications by brokers

The FINRA Standards impose significantly less burden on funding portals than the FINRA rules that apply to communications by brokers. The rules that apply to brokers communications with the public (principally FINRA Rule 2210) do not apply to funding portals. While the same general principles of fair dealing, etc. that apply to portals also apply to brokers, brokers are permitted to make recommendations and so there are a lot more rules about the basis upon which recommendations can be made. Funding portals are not required to get FINRA approval of communications before they are issued.

Additionally, brokers must review issuer-prepared communications. Funding portals are not required to do so, although for reputational reasons, you might wish to know what your issuers are saying.

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If you have any questions about any of these issues, please feel free to contact us:

Sara Hanks: sara@crowdcheck.com
Andrew Stephenson: andrewstephenson@crowdcheck.com
Huiwen Leo: huiwen@crowdcheck.com
Jamie Ostrow: jamie@crowdcheck.com

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