



Best practices for 17(b) disclosure by online investment platforms and other parties

Section 17(b) of the Securities Act was originally intended to prevent investors from being duped by stock tip sheets that were paid for by the issuer of the securities being recommended.

This is what Section 17(b) says:

It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

Note that there is no reference to lying about the stocks, or any outright “pump and dump” type fraud. These days, with Rule 506(c) permitting general solicitation of private offerings of securities, it is possible for a wide range of functions that are perfectly legitimate in themselves to raise 17(b) concerns.

Some of our friends have asked us to recommend some best practices in this area. While you should check these recommendations with your own attorney, these are some of the suggestions we came up with. They might not work for all entities in all situations, but they may be a useful starting point for developing your own best practices. We suggest different options for different kinds of players in the online alternative investment market.

Bulletin boards

- Make the disclosure below on the profile page for each company.
- Make the disclosure below on every email sent with respect to one or more companies (repeated for each company in the case of emails covering more than one company).
Alternatively, the email could state that it is paid advertising and provide a link to the company-specific text set out on the profile page of the company.
- Tweets should link to profile page disclosure if possible.

Brokers

- The broker-dealer must comply with all SEC and FINRA requirements relating to the type of commissions, markups, service charges, etc. that can be charged and how those charges have to be disclosed. Compliance with the fee disclosure requirements that apply to brokers (which goes beyond compliance with these guidelines) will likely encompass compliance with Section 17(b), but the regulators are able to use a charge of non-compliance with Section 17(b) as a “catch-all” for inadequate fee disclosure.

- If the broker is providing brokerage hosting services for a platform that is not itself a broker, then the non-broker platform should follow the guidelines set out for bulletin boards.

Venture Funds

- In the event there are any fees payable by the issuer (which in this case will be either the single-purpose LLC OR the issuer of the securities that the LLC will acquire) as opposed to the investors, then follow the guidelines for bulletin boards below.

Advertising and marketing agencies

- If the agency provides a website where offerings are described, follow instructions for bulletin boards below.
- Videos and content ads should state “Paid advertising” and provide a link to the company-specific disclosure text set out below.

“Pay to Pitch” conference organizers

- If you are taking money from companies in order to present those companies to potential investors and you use the “means of interstate commerce” to do so (for example, emails to conference attendees that mention the names of the companies pitching, or webcasts of the pitch event), provide the disclosure set out below in conference materials that describe the companies pitching.

Suggested disclosure¹

Disclosure under Section 17(b) must state that the person making the communication is paid to do, whether such payment is in cash or securities, and the amount of the payment. General disclosure such as “[Platform] may have received payment for this communication” is not sufficient. Linking to an outline of pricing terms is not sufficient. The disclosure must be specific to the company whose securities are being promoted. The language set out below is obviously just a suggested starting point, and must reflect the actual contractual arrangement between the issuer, the platform, and any hosting broker-dealer that the platform has a relationship with.

Flat fee (cash):

“[Platform] is compensated by the issuer for publicizing the offering of the issuer’s securities. Payment is made in cash and is billed [monthly]. As of [last day of previous month/other fixed date, no more than 30 days earlier] the issuer had paid [Platform] \$XXX for its services, which commenced [date]. Additional fees may have accrued since then.”

Flat fee (securities):

¹ In some cases, such as where the platform is using Google AdWords or on Twitter, it may not be possible to ensure that the first piece of information that a prospective investor sees bears the appropriate disclosure. In such cases, where possible include the words “paid advertising” and ensure that the first landing page the promotor has control over bears the disclosure.

“[Platform] is compensated by the issuer for publicizing the offering of the issuer’s securities. Payment is made through the issuance of securities to [Platform] [on a one-time basis/accruing monthly]. As of [last day of previous month/other fixed date, no more than 30 days earlier] the issuer had issued XXX [type of security], representing approximately XX% of [type of security] issued for its services, which commenced [date]. Additional issuances may have accrued since then.”

Commission (in addition to any specific disclosure to be made by brokers); this will of course have to be tailored to the specific fee arrangements in effect:

“[Platform] is compensated by the issuer for publicizing the offering of the issuer’s securities. Compensation will be received by both [Broker] and [Platform]. Compensation to [Broker] takes the form of a commission, payable in cash by the issuer to [Broker], in the amount of XX% of the total amount raised in this offering. Additionally, [Platform] will receive \$XXX for non-brokerage services, [summarize how the Platform will be compensated for its services under the contract between issuer, Broker and Platform] [e.g., netted from the commission if earned and otherwise due and payable for services rendered].”

Contact:

Sara Hanks

(703) 5487263

sara@crowdcheck.com

This is not legal advice and you should consult an attorney with any questions about Section 17(b).