Article

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The Guide to Social Media and the Securities Laws

REGULATION FD

Beginning in 1999 and continuing into 2000, media reports about selective disclosure of material nonpublic information by issuers raised concerns that select market professionals who were privy to this information profited at the expense of others. A consensus began to emerge that selective disclosure (1) adversely affects market integrity (to a similar extent as insider trading does) and (2) allows issuers to use nonpublic information unfairly to gain favor with analysts or investors.[1]

In response to the perceived threat presented by selective disclosure of material nonpublic information, by issuers, the Securities and Exchange Commission (SEC) adopted Regulation Fair Disclosure ("Regulation FD") in 2000. Regulation FD requires an issuer that discloses material nonpublic information to certain individuals (generally holders of the issuer's securities and securities market professionals) to also make the information publicly available. The required timing of the public disclosure depends on whether the issuer selectively disclosed the information intentionally or not. For an intentional selective disclosure, the issuer must simultaneously present the material to the public. If the issuer made the selective disclosure unintentionally, it must promptly disclose the information to the public.

Regulation FD provides that a person acting on behalf of a company includes (1) any senior official of the issuer or (2) any other officer, employee or agent of an issuer who regularly communicates with any of the enumerated persons described in Regulation FD (generally thought to include directors, senior officers, investor relations and public relations officers, or people who perform similar functions, as well as any other agents or employees of a company who regularly communicate with company investors and market professionals). Regulation FD also extends to any employee that has been directed to make a selective disclosure by a member of senior management. If a noncovered employee makes selective disclosure, and if that employee has been directed to make the selective disclosure by someone who is a senior official, then the senior official would be held responsible for the selective disclosure.

The question of who is a "covered person" for Regulation FD purposes is important from a social media perspective because those within a company who are responsible for social media communications may not be the most senior executives in the company, and may have a role that is different from the role of traditional investor relations professionals. Here's a principal concern: An employee responsible for tweeting, or posting on Facebook, or providing information through another social media outlet, may not be a senior official or person who generally communicates with the company's investors or market professionals. Nonetheless, Regulation FD's requirements may apply when the employee is handling and communicating material nonpublic information about the company.

[1] *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716 (Aug. 24, 2000).

Moreover, covered persons must carefully consider whether statements made through social media would be considered personal to the individual and not subject to regulation, or rather statements attributable to the company.

Determining If Information Posted on a Website Is Public

Regulation FD effectively requires issuers to consider whether they adequately disseminate information to the public. When the SEC adopted Regulation FD in 2000, it indicated that public disclosure "may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public."[2]

Since then, issuers have disclosed significantly more of information on their websites.[3] In 2000, the SEC stopped short of stating that it considered disclosure on a company's website to be adequate public dissemination.[4] At the time, the SEC indicated that "[a]s technology evolves and as more investors have access to and use the Internet," the SEC might consider a website posting to meet the public disclosure requirements of Regulation FD.[5] In 2008, the SEC addressed the issue in an interpretive release providing guidance as to whether information on a company's website could be considered a sufficient means of public disclosure for the purposes of Regulation FD. The SEC determined that when a company is evaluating if information posted on its website is public or not, the company must consider whether:

- a company website is a recognized channel of distribution;
- posting of information on a company website disseminates the information in a manner making it available to the securities marketplace in general; and
- there has been a reasonable waiting period for investors and the market to react to the posted information.[6]

In determining whether a company's website is a recognized channel of distribution, the analysis focuses on what the company has done to notify investors and the market of its website and disclosure policy. The SEC indicated that steps a company can take to establish its website as a recognized channel for disclosing information include:

- listing a company's website address on periodic reports and press releases;
- establishing a pattern of posting important information on its website; and
- informing investors that they can find important information about the company on its website.

In evaluating whether the posting of information on a company website disseminates the information in a manner making it available to the public in general, the SEC indicated that companies should focus on the manner in which the information is posted on a company's website and the accessibility of such information. Questions that a company should consider include:

[2] *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,716.

[3] *Commission Guidance on the Use of Company Web Sites*, 73 Fed. Reg. 45,862 (Aug. 7, 2008).

[4] *Id.*

[5] *Id.*

[6] *Id.*

- Is the website designed to effectively direct visitors to important information?

- Is information for investors prominently displayed on the website?

- Do the media regularly pick up and report information posted on the company's website?

The SEC also noted that a company can also improve the accessibility of information on its website by utilizing "push" technology. Push technology is a type of communication that originates with a publisher of the information, such as an RSS feed, in contrast to the concept of a "pull" communication, which originates with the consumer of information.

In determining if there has been a reasonable waiting period for investors to react to information posted on a company's website, the SEC indicated that the analysis depends on the circumstances of the dissemination. For a website, this means evaluating the traffic that the site generates, how often investor-specific information is accessed and the complexity of the information presented. For example, simple information posted on a website with heavy traffic that is routinely used by investors would likely be considered disseminated to the public sooner than complex information that is posted on a website with little traffic and that is not routinely used by investors.

Rule 101(e) of Regulation FD specifies that the filing or furnishing of information on a Form 8-K is sufficient to make the information public for the purposes of Regulation FD, notwithstanding any other efforts on the part of a company to utilize some broad, nonexclusionary means to disseminate that information. In public forums, the SEC Staff has indicated that an effective model for accomplishing the dissemination of information in a Regulation FD-compliant manner, at least with earnings announcements, would be to first furnish to the SEC an earnings release with an Item 2.02 Form 8-K, and then, following confirmation of the appearance of the filing on EDGAR, proceed with website posting of the earnings release.

The factors for determining if information has been adequately disseminated to the public for the purposes of Regulation FD are equally applicable for determining if information is publicly available for anti-fraud purposes.[7] For example, a potential plaintiff or the SEC would likely not be able to successfully allege that material nonpublic information had not been adequately disclosed to the market in the course of trading by a company in its own securities if the company had taken the necessary steps discussed above to disseminate the information.

To facilitate an ongoing determination that a company's website is a recognized channel of distribution of material information concerning the company, it is suggested that the company take the following steps:

- In all company communications to investors, include a statement that the company routinely posts all important information about the company on its website and include a reference to the URL of the company's website.

- Consider including a separate means to access the Investor Relations pages of the company's website from the main page of the website so that it is more readily apparent where investors may locate important information about the company that is posted on the company's website.

[7] Listed public companies also must consider stock exchange guidelines on the release and dissemination of information. Both the New York Stock Exchange and NASDAQ have policies that require prompt release of material nonpublic information to the public in a manner that is compliant with Regulation FD.

- Monitor the dissemination of information to determine the extent to which information reaches intended audiences and the extent to which persons access the company's website for material information about the company.

SEC Guidance on the use of Social Media

As companies began to rely more heavily on social media, a critical question is whether public dissemination of information through social media is adequate for purposes of compliance with Regulation FD.

In a Report of Investigation under Section 21(a) published on April 2, 2013, the SEC said that social media channels—such as Twitter and Facebook—could be used by public companies to disseminate material information, without running afoul of Regulation FD.[8] The SEC emphasized that companies should apply the guidance from its 2008 interpretive release regarding the disclosure of material information on company websites when analyzing whether a social media channel is in fact a "recognized channel of distribution," including the guidance that investors must be provided with appropriate notice of the specific channels that a company will use to disseminate material nonpublic information.

Section 21(a) of the Exchange Act authorizes the SEC to investigate violations of the federal securities laws and, in its discretion, "to publish information concerning any such violations." Section 21(a) Reports do not represent an adjudication of the facts or issues addressed. Rather, they express the SEC's views regarding the matters discussed in the report. Because the Section 21(a) Report describes the views of the SEC, it can serve as authoritative interpretive guidance on the matters discussed, much like an SEC interpretive release. In the course of an investigation of a potential Regulation FD violation arising from a CEO's Facebook post, the SEC Staff learned that there was uncertainty as to how the 2008 Guidance should apply in the context of releasing information through social media channels, so the SEC determined that the 21(a) Report would serve as a vehicle for communicating how to apply Regulation FD and the 2008 Guidance to communications made through social media channels. The SEC did not initiate an enforcement action or allege wrongdoing in connection with issuing the 21(a) Report.

The SEC confirmed in the 21(a) Report that Regulation FD applies to social media and other emerging means of communication used by public companies in the same way that it applies to company websites as discussed in the 2008 Guidance, which clarified that websites can serve as an effective means for disseminating information if investors have been made aware that they can locate the company information on the website.

The 21(a) Report indicates that, while every situation must be evaluated on its own facts, disclosure of material nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors that the social media site may be used for this purpose, is unlikely to qualify as an acceptable method of disclosure under securities laws. In this regard, the SEC notes that it would not normally be assumed that the personal social media sites of public company employees would serve as channels through which the company discloses material nonpublic information.

The SEC acknowledges in the 21(a) Report that the ways in which companies may use social media channels are not fundamentally different from the ways in which the websites, blogs and RSS feeds addressed by the 2008 Guidance are used. In revisiting the 2008 Guidance in the context of social media channels, the SEC notes that the 2008 Guidance was designed to be flexible and adaptive, and therefore provides issuers "with a factor-based framework for analysis, rather than static rules applicable only to web sites." In analyzing whether a website is a recognized channel of distribution, the SEC notes:

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[8] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings*, Release No. 34-69729 (April 2, 2013) (the "21(a) Report").

> The central focus of this inquiry is whether the company has made investors, the market, and the media aware of the channels of distribution it expects to use, so these parties know where to look for disclosures of material information about the company or what they need to do to be in a position to receive this information.

In analyzing how Regulation FD applies to any communication, the SEC notes that while the Regulation FD adopting release highlighted concerns about "selective" disclosure of information to favored analysts or investors, "the identification of the enumerated persons within Regulation FD is inclusive, and the prohibition does not turn on an intent or motive of favoritism." The SEC also emphasizes that nothing in Regulation FD suggests that disclosure of material nonpublic information to a broader group that includes *both* enumerated and non-enumerated persons, but that still would not constitute a public disclosure, would somehow result in Regulation FD being inapplicable. Rather, the SEC states that "the rule makes clear that public disclosure of material nonpublic information must be made in a manner that conforms with Regulation FD whenever such information is disclosed to any group that includes one or more enumerated persons." As a result, whenever a company discloses information to enumerated persons, including to a broader group of recipients through a social media channel, the company must consider whether that disclosure implicates Regulation FD. Issuers should determine, for example, whether the disclosure includes material nonpublic information and whether the information was being disseminated in a manner "reasonably designed to provide broad, non-exclusionary distribution of the information to the public" in the event that the issuer did not choose to file a Form 8-K.

Drawing on the reference to "push" technologies (such as email alerts, RSS feeds and interactive communication tools, such as blogs) in the 2008 Guidance, the SEC acknowledged that social media channels are an extension of these concepts, and therefore the guidance should apply equally in the context of social media channels. Given the "direct and immediate communication" possible through social media channels, such as Facebook and Twitter, the SEC expects companies to examine whether such channels are recognized channels of distribution. In particular, the SEC emphasized the need to take steps to alert the market about which forms of communication a company intends to use for the dissemination of material nonpublic information. The SEC notes that without this sort of notice, the investing public would have to keep pace with a "changing and expanding universe of potential disclosure channels." The ways in which such notice could be provided would include (1) references in periodic reports and press releases on the corporate website and disclosures that the company routinely posts important information on that website and (2) disclosures on corporate websites identifying the specific social media channels a company intends to use for the dissemination of material nonpublic information (thereby giving people the opportunity to subscribe to, join, register for, or review that particular channel).

In light of the SEC's guidance, companies should consider whether to specifically address the use of social media in their Regulation FD policies, including whether prohibitions, restrictions or editorial oversight should be implemented to govern the use of social media by those persons authorized to speak for the company. This area is still evolving, and should be continuously monitored, as the methods for interacting with shareholders, analysts and others continue to evolve.

As with the 2008 Guidance, companies may not be able to implement the 21(a) Report's guidance to eliminate more traditional forms of public dissemination. But the guidance may provide more comfort for companies using social media to supplement other more traditional forms of communication. Companies should carefully evaluate which social media channels may be useful for communicating information and begin providing notice to investors in the company's filings that information about the company may be found on those social media channels, while using those channels as a regular source of information. At the same time, companies should advise individual officers, directors and employees that posting information about the company on social media channels could potentially implicate Regulation FD, and therefore such persons must exercise caution when communicating through social media.

FORWARD-LOOKING STATEMENTS

Issuers often include forward-looking information, such as estimates, projections, plans and beliefs regarding future performance in their required public filings. Section 27A of the Securities Act of 1933 (the "Securities Act") and the Exchange Act provide a safe harbor from liability for forward-looking statements if a statement is:

- identified as a forward-looking statement; and
- accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from the forward-looking statement.

Twitter's 140-character limit, for example, may present challenges for issuers seeking to rely on the safe harbor for forward-looking statements. This limit is hardly enough space to accommodate the statement itself, let alone language identifying the statement as forward-looking and cautioning the reader as to potential factors that could cause actual results to differ materially from the forward-looking statement. Some companies have attempted to address the problem by posting multiple-tweet disclaimers before tweeting presentations that include forward-looking information. Other companies have sought to address this concern by linking to a web page, SEC report or press release where information about the forward-looking statements is provided in full. It remains uncertain whether a court would determine that either of these methods provides a means by which the forward-looking statements are identified and are accompanied by meaningful cautionary statements.

NON-GAAP MEASURES

Issuers should consider Regulation G, which requires issuers to reconcile non-GAAP financial information to a comparable GAAP financial measure, when publishing financial performance in social media. Similar to the approach taken with forward-looking statements discussed above, issuers providing non-GAAP financial information through Twitter have used multiple tweets in order to include the necessary accompanying disclosure required by Regulation G, or have provided links to where the reconciliation information is provided elsewhere. As with forward-looking statements, there is a threat that posts such as these will be taken out of context or only partially re-tweeted (resulting in a communication that may not be considered fully compliant with Regulation G).

ADOPTION OF OR ENTANGLEMENT WITH THIRD-PARTY STATEMENTS

The SEC has generally taken the view that a company is not responsible for statements that third parties post on a company-sponsored website, nor does a company have any obligation to correct a misstatement made by a third party. A company can be held liable for third-party information to which it hyperlinks from its website and which could be attributable to the company through concepts of entanglement or adoption.

Chief among a company's concerns in adopting or being entangled with the statements of another is that the statements could be deemed misleading under the federal securities laws and as a result the company could be deemed liable for the statement. Issuers should therefore be careful when referencing, and especially when linking to, online content that they do not control. Particular care should be taken when linking to content that may change after the link is posted, as even diligent monitoring cannot ensure that a member of the public will not follow the link and find materially misleading information. Moreover, activity such as "friending" a securities research analyst on Facebook or tweeting an analyst's handle on Twitter—as well as re-tweeting an analyst's tweet about the company—could potentially be construed as adoption of the analyst's past and future statements about a company or its securities.

LIABILITY FOR MISSTATEMENTS AND OMISSIONS

Electronic communications, including through social media websites, can create risks due to the rapid and often informal nature of the communications. However, given the potential liability for a material misstatement or omission in public communications, companies and their counsel are well-advised to treat any statements by or on behalf of the company made through social media websites with the same care that is used when evaluating disclosures included in SEC reports and press releases.

PROXY SOLICITIAIONS

Many types of communications, including those made over social media, can be considered a proxy solicitation that is subject to the SEC's proxy rules. Rule 14a-1 defines "solicitation" and "solicit" to include any "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding, or revocation of a proxy." Proxy solicitations are subject to SEC requirements, including in some instances filing requirements, as well as the applicability of anti-fraud rules. Social media communications by a company could be deemed to be proxy solicitations, and investors may in turn communicate about issues regarding a proxy solicitation through social media outlets. Because the definition of "solicitation" is so broad, companies need to take care to avoid the appearance of a proxy solicitation in the course of their communications. This includes all communications made over social media. Even if the communication is designed to merely inform the public or does not specifically reference a proxy or the company's proxy statement, courts could still find that a communication should be deemed to be a solicitation.

Exchange Act Rule 14a-17 permits the use of electronic shareholder forums to facilitate communications within limits prescribed by the rule. Under this provision, a company that sets up or runs an electronic shareholder forum will not be liable under the federal securities laws for any statement made or information provided "by another person" on the forum. If the SEC were to take the position that social media websites such as Twitter or Facebook constitute such a forum, it would provide companies with express protection for the statements of third parties on these social media websites.

A company remains responsible for its own statements and statements made on its behalf and could also be held responsible for a third-party statement if the company takes action to adopt, endorse or approve the statement. For example, if a user tweets a false or misleading statement about a company, and the company then tweets in a way that approves the statement through an exchange with the user, then the company could be held responsible for that statement. Rule 14a-2 provides express protection with respect to the proxy solicitation rules in the context of electronic shareholder forums, as long as the communication occurs 60 days prior to the date of the company's annual or special shareholder meeting and no proxy is sought.

CAPITAL RAISING CONSIDERATIONS

The use of social media for company communications can raise concerns in connection with both private and public offerings of securities. Social media communications could potentially result in impermissible general solicitation or general advertising in connection with a private offering and gun-jumping or conditioning the market in connection with public offerings. At the same time, social media may prove useful in the context of new mechanisms for raising capital, such as under the provisions relating to certain Rule 506 offerings or those for conducting exempt crowdfunding offerings contemplated by the recently enacted JOBS Act.

Private Offerings

Many private offerings of securities are conducted under Regulation D, which provides an exemption for offerings meeting the conditions specified in the Regulation. Over time, companies have come to rely frequently on Rule 506 of Regulation D, which permits issuers to sell their securities in a private placement to an unlimited number of accredited investors, provided that issuers comply with the general requirements of Regulation D. Historically, Rule 502(c) of Regulation D prohibited the issuer or any person acting on its behalf to offer or sell securities by any form of general solicitation or general advertising, including, but not limited to, “any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.” This prohibition on the use of general solicitation and general advertising in private offerings made in reliance on Regulation D was criticized by many market participants as anachronistic given the development of communications technologies. Title II of the Jumpstart Our Business Startups (JOBS) Act, titled “Access to Capital for Job Creators,” addressed the prohibition on general solicitation by mandating that the SEC undertake rulemaking to amend Rule 506 to make the prohibition against general solicitation or general advertising contained in Rule 502 inapplicable in the context of Rule 506 offerings, provided that all purchasers in the offering are accredited investors. Congress believed that by removing this restriction on communications, emerging companies would be able to raise capital more easily and contact investors with whom they may not have a pre-existing relationship.

The SEC adopted the required amendment in July 2013 and the amended rule becomes effective September 23, 2013. Following the effective date, an issuer may decide to rely on existing Rule 506(b) to conduct a private offering without using general solicitation or general advertising. Alternatively, an issuer may choose to rely on new Rule 506(c), which would permit the use of general solicitation and general advertising, subject to the following conditions:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of securities must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they qualify as accredited investors, at the time of the sale of the securities; and
- The issuer satisfies the conditions of Rule 501 and Rules 502(a) and 502(d).

An issuer relying on Rule 506(c) must take “reasonable steps” to verify that investors are accredited investors. The Staff indicated that “reasonable efforts” to verify investor status will be an objective determination by the issuer based on the SEC’s principles-based guidance. The SEC noted that, in determining whether it has taken reasonable steps to verify investor status, an issuer should consider the nature of the purchaser; the nature and amount of information about the purchaser; and the nature of the offering. The amended rule also provides a nonexclusive list of factors to consider in verifying the accredited investor status of natural persons.

In addition to the changes adopted to Rule 506, the SEC amended Rule 144A to eliminate references to “offer” and “offeree,” and, as a result, Rule 144A will require only that the securities are sold to a qualified institutional buyer, or QIB, or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB. The changes to Rule 506 and Rule 144A have no effect on the statutory private placement exemption available under Section 4(a)(2) of the Securities Act. General solicitation or general advertising cannot be used in the context of an offering exempt from registration in reliance on the Section 4(a)(2) exemption.

The relaxation of the ban on general solicitation and general advertising for certain Rule 506 offerings likely will facilitate wider use of social media in connection with private offerings. Prior to commencing any private offering, an issuer and its advisers should consider carefully whether the issuer will employ general solicitation, and determine the means by which the issuer intends to communicate with potential investors about a possible financing. Documentation, including engagement letters with financial intermediaries, placement agency agreements and offering memoranda, is likely to change as a result of the amended rules. An issuer will remain liable for the content of any general solicitation it makes in connection with a securities offering. As a result, issuers should consider updating their Regulation FD policies and their communications policies to ensure that they address communications made in the context of securities offerings. Also, certain types of issuers, such as private funds and their registered investment advisers, as well as commodity pools, will be subject to specific restrictions on the content of their communications.

Public Offerings

"Gun-jumping" refers to impermissible offers of securities by companies in connection with a registered securities offering. Gun-jumping is a particular concern when companies use, or their employees use, social media during the time leading up to an initial public offering. The SEC has indicated that statements made through electronic means, such as website postings and emails, can be deemed written offers for the purposes of the communications rules under the Securities Act. Therefore, an electronic communication that relates to the issuer or its prospects may be deemed to be an offer of securities or otherwise "condition the market" for the offering, subjecting the issuer to liability for making an illegal offer of securities.

Because impermissible communications in connection with an offering can have significant consequences for the company and offering participants, social media use should be subject to special controls by companies contemplating a public offering. In some cases, companies contemplating an initial public offering stop making postings on company-sponsored Twitter accounts. Ongoing monitoring of social media communications is necessary to avoid concerns that written offers are being made other than by means of a prospectus or other permitted communications. There is close scrutiny of company websites, media outlets and other information sources in connection with the review of registration statements by the SEC.

Title I of the JOBS Act, titled "Reopening American Capital Markets to Emerging Growth Companies," establishes a new category of issuer, an "emerging growth company," for which certain disclosure and other requirements will be phased in over time following a company's initial public offering. The JOBS Act amends the Securities Act and the Exchange Act to add a definition of an "emerging growth company." An emerging growth company is defined as an issuer with total gross revenues of less than $1 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year. A company remains an "emerging growth company" until the earliest of:

1. the last day of the fiscal year during which the issuer has total annual gross revenues in excess of $1 billion (subject to inflationary indexing);

2. the last day of the issuer's fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act;

3. the date on which such issuer has, during the prior three-year period, issued more than $1 billion in nonconvertible debt; or

4. the date on which the issuer is deemed a "large accelerated filer."

An issuer will not be able to qualify as an emerging growth company if it first sold its common stock in a registered offering prior to December 8, 2011.

An emerging growth company may submit a draft registration statement to the SEC for confidential nonpublic review prior to public filing, provided that the initial confidential submission and all amendments thereto shall be publicly filed with the SEC no later than 21 days prior to the issuer's commencement of a road show. Emerging growth companies may engage in oral or written communications with qualified institutional buyers, or QIBs, and institutional accredited investors (as defined in Rule 501 of the Securities Act) in order to gauge their interest in a proposed initial public offering either prior to or following the first filing of the registration statement. While these provisions provide increased flexibility with respect to communications for emerging growth companies prior to and after filing a registration statement for an initial public offering, the requirement that communications take place only with QIBs and institutional accredited investors substantially limits the availability of more broadly accessible social media as a means for making any such communications.

Given the relaxation of the ban on general solicitation in certain Rule 506 offerings discussed above, issuers and their advisers also should consider the possibility that a permitted general solicitation in the context of a Rule 506(c) offering immediately preceding an initial public offering may be viewed as gun-jumping.

Crowdfunding

Crowdfunding is an emerging source of financing that has its roots in social media. It is a concept where people pool their relatively small contributions together to fund a common enterprise. Title III of the JOBS Act, titled "Crowdfunding," amends Section 4 of the Securities Act to add a new paragraph (6) that provides a crowdfunding exemption from registration under the Securities Act. The conditions of the crowdfunding exemption, which must be established through SEC rulemaking, are that:

- The aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, is not more than $1,000,000;

- The aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, does not exceed:

    - the greater of $2,000 or 5 percent of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; or

    - 10 percent of the annual income or net worth of an investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;

- The transaction is conducted through a broker or funding portal that complies with the requirements of the exemption; and

- The issuer complies with the requirements of the exemption.

Among the requirements for exempt crowdfunding offerings would be that an intermediary:

- Registers with the SEC as a broker or a "funding portal," as such term is defined in the amendment;

- Registers with any applicable self-regulatory authority;

- Provides disclosures to investors, as well as questionnaires, regarding the level of risk involved with the offerings;

- Takes measures, including obtaining background checks and other actions that the SEC can specify, of officers, directors and significant shareholders;

- Ensures that all offering proceeds are only provided to issuers when the amount equals or exceeds the target offering amount, and allows for cancellation of commitments to purchase in the offering;

- Ensures that no investor in a 12-month period has invested in excess of the limit described above in all issuers conducting exempt crowdfunding offerings;

- Takes steps to protect privacy of information;

- Does not compensate promoters, finders or lead generators for providing personal identifying information of personal investors;

- Prohibits insiders from having any financial interest in an issuer using that intermediary's services; and

- Meets any other requirements that the SEC may prescribe.

Issuers also must meet specific conditions in order to rely on the exemption, including that an issuer file with the SEC and provide to investors and intermediaries information about the issuer (including financial statements, which would be reviewed or audited depending on the size of the target offering amount), its officers, directors and greater than 20 percent shareholders, and risks relating to the issuer and the offering, as well as specific offering information such as the use of proceeds for the offering, the target amount for the offering, the deadline to reach the target offering amount and regular updates regarding progress in reaching the target.

The provision would prohibit issuers from advertising the terms of the exempt offering, other than to provide notices directing investors to the funding portal or broker, and would require disclosure of amounts paid to compensate solicitors promoting the offering through the channels of the broker or funding portal.

Issuers relying on the exemption would need to file with the SEC and provide to investors, no less than annually, reports of the results of operations and financial statements of the issuers as the SEC may determine is appropriate. The SEC may also impose any other requirements that it determines appropriate.

A purchaser in a crowdfunding offering could bring an action against an issuer for rescission in accordance with Section 12(b) and Section 13 of the Securities Act, as if liability were created under Section 12(a)(2) of the Securities Act, in the event that there are material misstatements or omissions in connection with the offering.

Securities sold on an exempt basis under this provision would not be transferable by the purchaser for a one-year period beginning on the date of purchase, except in certain limited circumstances. The crowdfunding exemption only would be available for domestic issuers that are not reporting companies under the Exchange Act and that are not investment companies, or as the SEC otherwise determines is appropriate. Bad actor disqualification provisions similar to those required under Regulation A would also be required for exempt crowdfunding offerings.

Funding portals would not be subject to registration as a broker-dealer, but would be subject to an alternative regulatory regime, subject to SEC and SRO authority, to be determined by rulemaking at the SEC and SRO. A funding portal is defined as an intermediary for exempt crowdfunding offerings that does not:

1. offer investment advice or recommendations;

2. solicit purchases, sales or offers to buy securities offered or displayed on its website or portal;

3. compensate employees, agents or other persons for such solicitation or based on the sale of securities

displayed or referenced on its website or portal;

4. hold, manage, possess or otherwise handle investor funds or securities; or

5. engage in other activities as the SEC may determine by rulemaking.

The provision would pre-empt state securities laws by making exempt crowdfunding securities "covered securities"; however, some state enforcement authority and notice filing requirements would be retained. State regulation of funding portals would also be pre-empted, subject to limited enforcement and examination authority.

For those issuers who are seeking to raise small amounts of capital from a broad group of investors, the crowdfunding exemption may ultimately provide a viable alternative to current offering exemptions, given the potential that raising capital through crowdfunding over the Internet may be less costly and may provide more sources of funding. At the same time, issuers will need to weigh the ongoing costs that will arise with crowdfunding offerings, in particular the annual reporting requirement that is contemplated by the legislation. Moreover, it is not yet known how much intermediaries such as brokers and funding portals will charge issuers once SEC and SRO regulations apply to their ongoing crowdfunding operations.

SEC GUIDANCE FOR REGISTERED INVESTMENT ADVISERS

In January 2012, the SEC's Office of Compliance Inspections and Examinations ("OCIE") published a National Examination Risk Alert called *Investment Adviser Use of Social Media*, which outlines in stark terms the SEC Staff's compliance concerns on the use of social media by registered investment advisers.

The SEC Staff has stated its view that use of social media to communicate with clients and prospective clients may implicate Rule 206(4)-1 under the Advisers Act, which governs advertisements by investment advisers. This rule, in relevant part, provides that an investment adviser will violate the Investment Advisers Act's anti-fraud provisions if it publishes, circulates or distributes "any advertisement" that:

- Refers, directly or indirectly, to "testimonials of any kind concerning the investment adviser" or the investment advice it provides;

- Refers, directly or indirectly, to past specific recommendations it provides (e.g., "cherry picking"), unless the adviser discloses a list of all recommendations, subject to certain requirements;

- Represents that a graph, chart or formula, by itself, can be used to determine which securities to buy, without prescribed disclosures;

- Contains a statement to the effect that a report, analysis or other service will be furnished free of charge, unless it is actually provided entirely free of charge without condition; or

- That contains any untrue statement of a material fact, or that is otherwise false or misleading.

The SEC defines "advertisement" broadly. "Advertisements" include any notice, circular, letter or other written communication addressed to more than one person, or any notice or announcement in any publication or by radio or television, that (1) offers analysis, report or publication concerning securities, or that is to be used in making any determination as to when to buy or sell any security; or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security; or (3) any other investment advisory service with regard to securities. We can reasonably conclude that it applies to all kinds of social media communications, including blogs, wikis, photo and video sharing, podcasts, social networking and virtual worlds.

OCIE's regulatory concerns can be categorized into three broad categories: compliance policies and procedures, third-party content, and recordkeeping.

First, the SEC Staff is concerned that investment adviser compliance programs may include overlapping procedures that apply to advertisements and communications but do not specifically include social media. The Staff urges investment advisers to evaluate the effectiveness of their compliance programs with respect to use of social media by the firms, investment adviser representative or solicitors, including the following hot buttons:

- *Usage guidelines*. Compliance procedures should address appropriate usage and restrictions on use of social media, based on potential risks.
- *Content standards*. Content may implicate fiduciary duty or other regulatory issues, which procedures should address.
- *Monitoring*. Advisers should consider how to monitor use of social media by employees, representatives and solicitors, taking into consideration the lack of ability to monitor third-party sites.
- *Frequency of monitoring*. The Staff suggests a risk-based approach for frequency of monitoring of social media communications.
- *Approval of content*. Advisers should consider preapproval of communications, rather than after-the-fact reviews.
- *Firm resources*. Does the adviser have sufficient resources to adequately monitor personnel?
- *Criteria for approving participation*. Compliance procedures should assess risks to the adviser, including operational, reputational, privacy and other regulatory issues.
- *Training*. Advisers should consider implementing a training program related to social media, with a view toward promoting compliance.
- *Certification*. Consider procedures that require personnel to certify that they understand and will comply with social media policies.
- *Functionality*. Advisers should consider the functionality of social media sites approved for use, including the continuing obligation to address any upgrades or modifications.
- *Personal/professional sites*. Advisers should consider whether to adopt policies to address business conducted on personal or third-party media sites.
- *Information security*. Advisers should consider whether permitting representatives to have access to social media sites poses information security risks, and how to protect information.
- *Enterprise-wide sites*. Advisers that are part of a larger financial services or corporate enterprise may consider whether to create usage guidelines designed to prevent the advertising practices of a firm-wide social media site from violations of the Advisers Act.

Second, the Staff has indicated that third-party content on social media sites presents special compliance challenges. These issues arise when third parties post messages, forward links or post articles to an adviser's website or in social media sites. Adviser representatives and solicitors generally do not interact with their third parties or respond to their postings. The Staff noted its concern about direct or indirect testimonials "of any kind," and generally it broadly construes what constitutes a testimonial. A posting by a third party that comments on an adviser's stock picking prowess, the Staff warns, may amount to a prohibited "testimonial." Even hitting the "Like" button on an adviser's Facebook page could be a prohibited testimonial if the thumbs up represents an explicit or implicit statement of a client's experience with an investment adviser or its representative.

The SEC Staff's third area of concern is recordkeeping obligations of advisers. OCIE noted that the recordkeeping rules do not differentiate between traditional paper communications, like snail mail, and electronic communications, such as emails, instant messages and other ways that investment advisers provide advisory services. In other words, the federal regulators focus on the *content* of the communication, rather than its *form*. OCIE urges investment advisers to ensure that their recordkeeping policies and procedures allow advisers that use social media to comply with the recordkeeping requirements.

At the same time, the SEC published an Investor Alert, *Social Media and Investing: Avoiding Fraud*, designed to make investors aware of fraudulent investment schemes that use social media, and provides tips for checking the backgrounds of investment advisers and brokers. *An Investor Bulletin, Social Media and Investing, Understanding Your Accounts* provides tips for investors who use social media about privacy settings, security and password selection. Also on the same day, the Enforcement Division announced that the SEC charged an Illinois-based investment adviser with offering to sell fictitious securities on LinkedIn. Among other things, the Division alleged that the adviser used LinkedIn discussions to promote fictitious "bank guarantees" and "medium term notes," which generated interest from potential investors. The adviser failed to comply with recordkeeping requirements or maintain a required Code of Ethics.

The SEC's Enforcement Division noted that fraudsters are quick to adapt to new technologies to exploit them for unlawful purposes. This case suggests that the federal regulators are determined to adapt to new technologies to follow the fraud.

FINRA GUIDANCE FOR BROKER-DEALERS

On August 18, 2011, FINRA issued Regulatory Notice 11-39, providing guidance to broker-dealer members on social networking websites and business communications. The notice updated FINRA's guidance in Regulatory Notice 10-06 from January 2010. Regulatory Notice 10-06 provides guidance on the application of FINRA rules governing communications by FINRA member firms with the public through social media sites, and reminds member firms of certain requirements relating to those communications. [9]

To understand the guidance, it is important to understand the difference between static and interactive electronic communications. Since 1999, FINRA has taken the position that participation by a registered representative of a member firm in an Internet chat room is comparable to a presentation made to a group of investors and, accordingly, is subject to the same rules applicable to presentations. This position was codified in 2003 when FINRA Rule 2210 was amended to include the participation in an interactive electronic forum in the definition of "public appearance." Hence, the FINRA rules do not require prior approval of postings by member firms or their associated persons on interactive electronic forums. Static communications or postings are regulated as "advertisements" under FINRA rules and, accordingly, are required to have been reviewed by a registered principal. Member firms and their associated persons must be careful to distinguish between static and interactive

[9] We note that updated FINRA communications rules became effective in February 2013. See Regulatory Notice 12-29 (June 2012). In Regulatory Notice 12-29, FINRA indicated that it was codifying its existing guidance.

electronic communications.

Interactive Electronic Forums

Although a blog (or a bulletin board) may seem to be an interactive electronic forum, for FINRA, the treatment of a blog will depend on the manner and purpose for which the blog has been constructed. Blogs consisting of static postings are deemed advertisements and their contents require prior principal approval prior to posting. Most blogs today are used to engage in real-time interactive communications with third parties. As a result, these blogs may be deemed interactive electronic forums and regulated as public appearances.

Social networking sites also may be subject to different rules, depending on the nature of the communication. Common social networking sites combine static content and real-time interactive communications (biographical information, status updates and wall uploads versus "comments" and "likes"). Static content remains posted until it is changed by the firm or individual who established the account. Generally, such content is accessible to all visitors of the site or page and is treated by FINRA as an advertisement. On the other hand, interactive content or nonstatic real-time communications have the characteristics of interactive electronic forums and do not need to be approved by a registered principal. Examples of nonstatic, real time communications include interactive posts, such as "comments" or "likes" on Facebook or "replies" on Twitter, and these are treated as public appearances. They remain subject to the supervision rules.

Although Regulatory Notice 10-06 treats blogs and social networking sites differently, firms should pay close attention to the substance of the communication, not the form. A contemporary blog that is based on real-time interactive communications may still combine static content with interactive content. Firms should consider treating static content on an otherwise interactive blog as advertisements subject to prior approval by a principal.

FINRA recently penalized a registered representative for, among other things, misrepresenting her career accomplishments and her employer firm on a profile posted on a third-party website without obtaining prior principal approval from her then-current employer. FINRA cited FINRA Rule 2110 and Rule 2210. The same representative was cited for violating FINRA Rule 2210 for "tweeting" a recommendation on a particular security without prior principal approval. According to FINRA, the content of the "tweets" was "unbalanced, overly positive and often predicted an imminent price increase." FINRA did not object to the form of the communication; it objected to the content and the lack of prior approval.

Filing and Recordkeeping

Almost all communications made by broker-dealers through social media channels will be regarded as "retail communications" under applicable FINRA rules. Broker-dealers should consult FINRA Rule 2210 and establish appropriate policies and procedures designed to ensure compliance with the supervisory review and/or FINRA filing requirements. Regulatory Notice 11-39 also addresses recordkeeping. Rules 17a-3 and 17a-4 under the Exchange Act and FINRA Rule 3110 require that a broker-dealer retain electronic communications made by the firm and associated persons that relate to the firm's business. In Regulatory Notice 11-39, FINRA clarified that the posting of any content on a website by a member firm or its associated persons is a communication under the FINRA rules and, accordingly, is subject to applicable FINRA recordkeeping rules. According to FINRA, the determination of whether an electronic communication relates to a firm's business "as such," and hence is subject to the recordkeeping rules, depends on the facts and circumstances and the context and the contents of the communication. Neither the type of device or technology used to transmit the communication nor the ownership of the device is relevant to the determination. Finally, with respect to recordkeeping rules, the requirements are the same for both static and interactive electronic communications.

Suitability

Recommendations to customers regarding the purchase, sale or exchange of any security are regulated under FINRA Rule 2310, more commonly referred to as the suitability rule. Recommendations through a social media website are covered under this rule.

Supervision

FINRA Rule 3010 provides that member firms must establish and maintain a system to supervise the activities of each registered representative, registered principal and other associated person, and that the system must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable FINRA rules. If an associated person wants to use a social media site for business purposes, FINRA rules require that a registered principal should review the site prior to its use, to the extent that the content is static. A site should be approved for use for business purposes only if the registered principal has determined that the associated person can and will comply with all applicable FINRA communication rules, federal securities laws and individual firm policies.

Links to Third-Party Sites

Regulatory Notice 11-39 also addresses the potential liabilities associated with third-party posts. FINRA explains that a firm may not establish links to third-party sites that the firm knows, or has reason to know, contain false or misleading content, and should not do so when there are red flags to that effect. Further, FINRA advises that under applicable communication rules, a firm may become responsible for content on third-party sites if the firm has adopted or becomes entangled with the content on the third-party sites. A firm may be deemed to be entangled with a third-party site if, for example, the firm participates in the development of content on the third-party site. Also, a firm may be deemed to adopt third-party content if it indicates on its site that it endorses the content on the third-party site. Many social media sites, such as LinkedIn, allow third parties to "recommend" a person and allow users to request recommendations. Member firms should consider prohibiting associated persons from soliciting recommendations. Otherwise, the firm may be deemed to have "adopted" the third-party recommendation.

This guidance is consistent with guidance issued by the SEC with respect to third-party information that is hyperlinked to a public company's site. Firms should make sure that any links to third-party sites are only accessible through a new window when linking to a site, and that a legend appears on the screen warning the reader that he or she is leaving the firm site and disclaiming any responsibility for third-party content. It is unlikely that such legends will shield a member firm from sanction by FINRA, if applicable, but posting such legends may be effective for limiting liability relating to customer claims. Firms should also make sure that their policies relating to social media sites address links to third-party sites.

Third-Party Posts, Third-Party Links and Websites

In addition to adoption and entanglement, if a member firm co-brands a third-party site, it will effectively adopt the content of the entire site. A member firm may co-brand a site by, among other things, placing the firm's logo prominently on the site.

Data Feeds

FINRA cautions that firms must manage data feeds inputted into their websites. As data feeds may contain inaccurate data, firms must be familiar with the proficiency of the vendor providing the data and its ability to provide accurate data. Managing data feeds involves understanding the criteria used by vendors in collecting or calculating the data, regular review of the data for red flags and promptly taking necessary measures to correct any inaccurate data.

Accessing Social Media Sites from Personal Devices

FINRA explains that firms may permit their associated persons to use personal communication devices to access firm business applications and to perform firm business activity. FINRA cautions, however, that a firm must be able to retain, retrieve and supervise business communications regardless of the ownership of the device used to transmit the communications. According to FINRA, firms should require, if possible, that representatives use separate applications on a device for business communications to facilitate retrieval of the business communications without retrieving personal communications. FINRA also notes that an application that provides a secure portal into a firm's communications system is preferable, especially if confidential customer information is shared. If a firm has the ability to separate business and personal communications on a device, and has adequate policies and procedures regarding usage, the firm will not be required to (but may voluntarily) supervise personal communications on the device. Firms should consider what devices are most compatible with their internal compliance efforts and require associated persons to limit their business communications to such devices. To facilitate retrieval, it is advisable to ask associated persons to limit personal communications to private email accounts and to prohibit business communications through firm email accounts.

SEC GUIDANCE FOR INVESTMENT COMPANIES

Investment companies do not necessarily have to file with the SEC interactive content posted in a real-time electronic forum (such as chat rooms or other social media) that is not required to be filed under FINRA Rule 2210.

In guidance published in March 2013, the Staff of the Division of Investment Management described the circumstances when registered investment companies must file interactive content under Section 24 of the Investment Company Act or Rule 497 under the Securities Exchange Act of 1933, and when it believes filing is not necessary.[10] The Staff takes the basic view that whether a fund must file a particular communication depends on the content, context and presentation of the particular communication. It requires the fund to examine the underlying substantive information transmitted to the social media user and consideration of other relevant facts and circumstances, such as whether the interactive communication is merely a response to a request for information, or whether the fund is sending previously-filed content. The guidance contained examples of interactive communications and how the Staff would view a fund's filing requirements.

For example, the Staff said that funds generally would not be required to file the following types of interactive communications:

- Incidental mention of specific funds unrelated to investment merits.
- Incidental use of the word "performance" in connection with discussion of a fund without specific mention of elements of the fund's return.
    - "We update performance of our funds every month and publish them on our website."
    - "When reviewing a fund's performance, it is important to consider performance against a benchmark."

[10] Investment Management Guidance No. 2013-01 (March 2013), available at http://www.sec.gov/divisions/investment/guidance/im-guidance-update-filing-requirements-for-certain-electronic-communications.pdf.

- Factual introductory statements including a hyperlink to a prospectus.
- Introductory statements unrelated to a discussion of investment merits of a fund that include a hyperlink and discussions of basic investment concepts or commentaries on economic, political or market conditions.
  - "Our date shows the average 401(k) balance is the highest it's been in more than 10 years! This is partly due to increasing employer and employee contributions."
  - "The election is over, what is next for our economy? See our report analyzing the elections."
- Responses to inquiries that provide discrete factual information unrelated to fund performance.

The Staff provided examples of interactive communications that funds should have to file:

- Discussions of fund performance that mention elements of a fund's return or that promote a return.
  - "The fund slightly underperformed its benchmark, the S&P 500 Index, during the quarter that ended March 31, 2013."
- Communications initiated by users that discuss investment merits of the fund
  - "Looking for dividends? Think global and consider our new Global Equity Fund [website URL]."

The Staff's guidance provided additional examples; those cited above are representative. In any case, the examples are designed to be nonexclusive.

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