



REVERSE inquiries
Workshop Series

Electronic Platforms – Legal Issues

Thursday, November 14, 2019

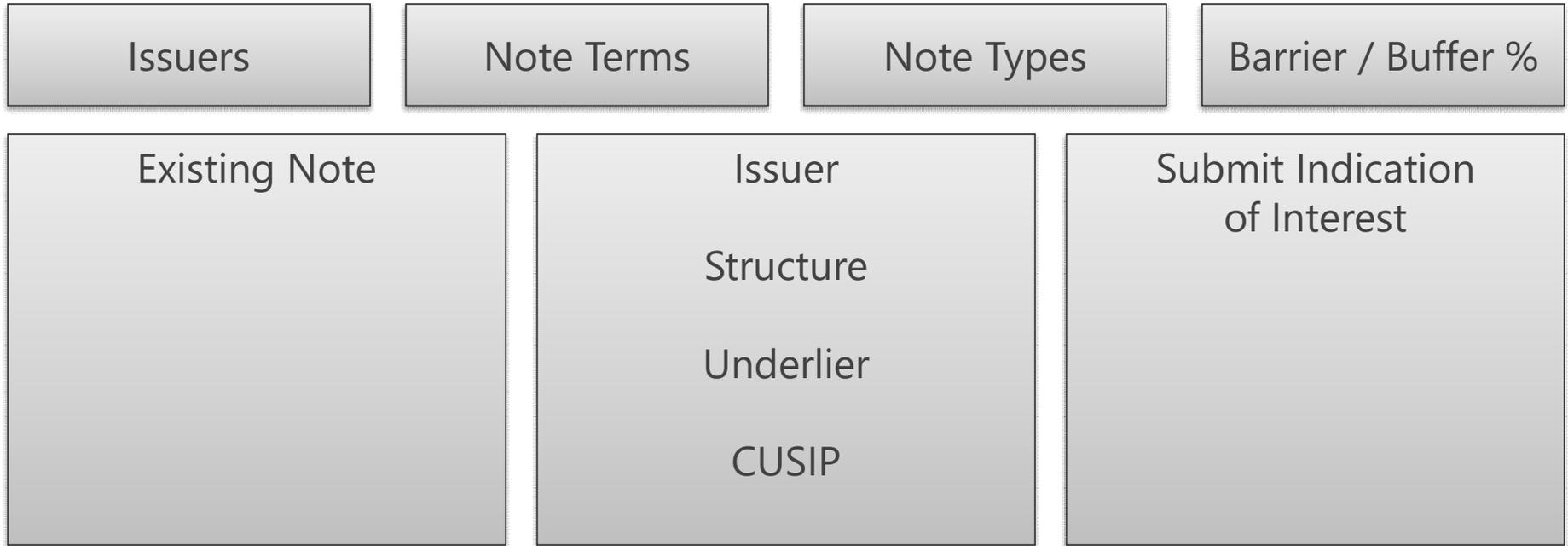
What tools does the platform offer?

- The platform generally will provide access to documents created by issuers, search capabilities to enable users to identify structured investments meeting particular criteria, and share content created by the platform operator
 - Issuers and/or their affiliated broker-dealers post offering documents on the platform
 - May be SEC-registered or exempt, such as Section 3(a)(2) offerings
 - Banks may post structured CDs offering documents
 - Sample document search/creation features:
 - Platform users may input their criteria for a reverse inquiry note, then submit that indication of interest or request for quote to some or all of the issuers on the platform
 - A platform user may set parameters, then existing offerings that match the request will appear as options for the user to inquire about from the relevant issuer
 - The platform may create backtested hypothetical data for the hypothetical structured product created in response to the inquiry

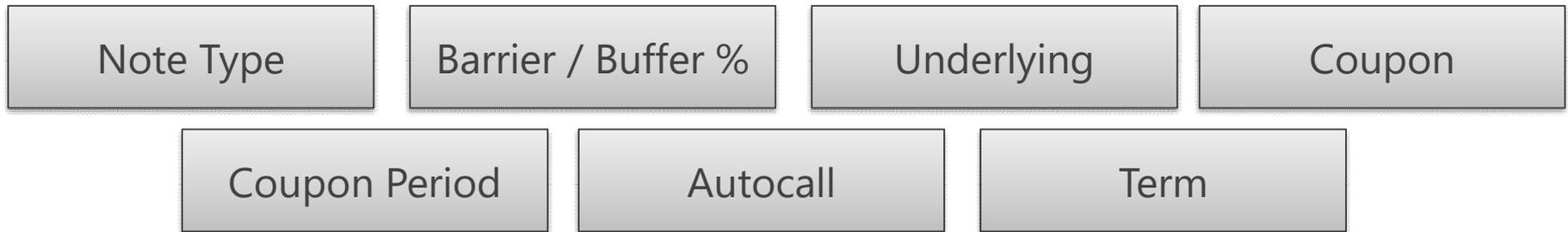
What tools does the platform offer? *(cont'd)*

- Platform operators generate their own content, available to some or all of the platform users
 - Generic educational materials/videos that do not reference any particular security or offering
 - Teaching materials designed to assist in training of associated persons of broker-dealers
 - Tracking or reporting of life cycle events

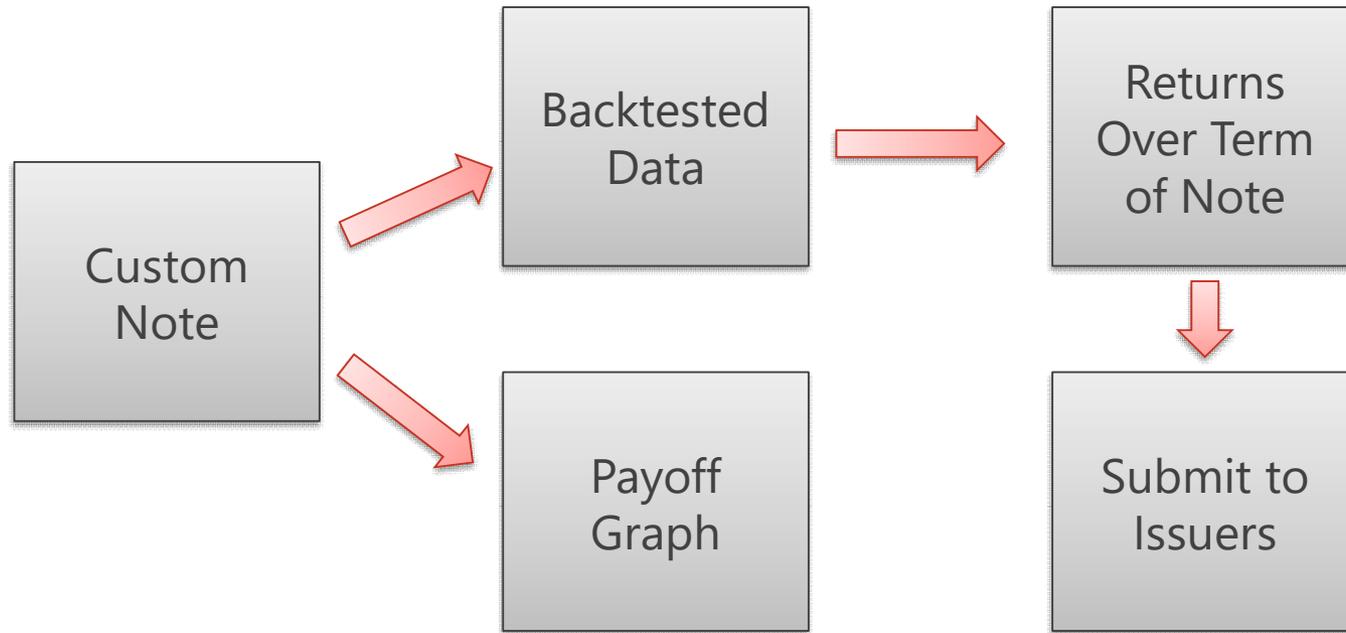
Sample platform screens – existing notes



Sample platform screens – reverse inquiry notes



Sample platform screens – reverse inquiry notes



Sample platform screens – educational content

Digital Notes

General Features

Income Notes

Videos

Glossary

Who is allowed access?

- Dealers
- Investment advisers registered under the Investment Advisers Act of 1940
- Banks acting as fiduciaries with trading discretion over client accounts

Must a platform operator be a broker-dealer?

- It depends
- To the extent that platform operators receive compensation that might be viewed as transaction-based compensation, such as a fee charged to issuers in connection with use of the platform to post offering materials relating to sales of the issuers' securities, registration as a broker-dealer likely will be required
 - But platform operators do not buy or sell securities
 - The platform operators are not in the distribution chain
 - They do not handle securities
 - They do not handle funds
 - They are not involved in documenting or negotiating the terms of any offering
 - There is no "trading" of securities on a platform
 - There is no straight-through processing of trades and confirmations
 - Offers and sales are made by the issuer or its affiliated broker-dealer through existing distribution arrangements

Must a platform operator be an investment adviser?

- It depends
- Portions of a platform that allow users to “build” a structured note, with step-by-step tools and explanations, might be considered investment advice by the platform to the user but this will be a highly fact specific assessment
- Could a platform be considered an unregistered investment adviser?
 - Limiting access to registered broker-dealers may mitigate this concern
 - Potential issue for users that are RIAs or Banks that are not also registered as dealers
- The risk also can be mitigated by clear disclaimers that the platform does not provide investment advice to its users. This can also be addressed contractually in the user agreement for the platform

Posting Offerings of Securities

Avoiding unintended offers

- An “offer to sell,” “offer for sale” or “offer” of securities under Section 2(a)(3) of the Securities Act must either be registered under Section 5 of the Securities Act or be within an applicable exemption.
- How may issuers avoid unintended offers on an electronic platform?
 - Ensure that offers are made solely through their offering documents;
 - Segregate content created by the platform provider from the issuer’s offering documents; and
 - Characterize communications relating to securities outside of the issuer’s offering documents as “indications of interest,” which are not offers
 - Restrict the recipients of indications of interest

Restricting recipients of communications

- Whether or not a communication relating to a security would be deemed an “offer” may depend on who receives the communication
- Dealers:
 - Communications between issuers and dealers may be considered “sell side” communications and not offers
 - But likely subject to the FINRA Rule 2210 content requirements (must be fair and balanced)
- RIAs and banks acting in a fiduciary capacity with investment discretion:
 - Communications may be considered “offers” under the Securities Act, depending on the facts and circumstances
 - Communications also would be institutional communications under FINRA Rule 2210

Restricting recipients of communications *(cont'd)*

- How to address:
 - Limiting RIA and Bank access to materials that are not related to any offering; and/or
 - Clearly identifying communications between issuers and RIAs and Banks that are related to a specific offering as “indications of interest”

Other communications issues—backtesting

- Backtested data should contain a legend clearly identifying it as such, pointing out that such data is hypothetical and subject to interpretation and that it should not be relied upon to forecast future performance.
- Generally, FINRA guidance in the 2013 ALPS Letter should be followed for backtested data:
 - Backtested data should go back at least 10 years and cover a variety of market conditions
 - Data should be created by applying the terms of the hypothetical note to actual market data
 - Clearly labeled as backtested data and that the actual performance of a note may vary significantly from the backtested performance

Other FINRA issues—recommendations

- Recommendations of an investment strategy, such as investment suggestions made through the facilities of a platform, to a customer, are subject to FINRA Rule 2111:
 - Dealers are not customers for purposes of the FINRA rules
 - Banks likely would be considered customers
 - Banks, as institutional accounts, might agree that they would make their own suitability determinations

Issuer content or platform content?

- The concern: the content created by the platform provider might be considered by a Dealer, RIA or Bank (or a regulator) to be part of, or subsumed in, the issuer's offering materials, with the issuer taking on prospectus liability for platform content.
- How to address?
 - Issuers and platform operators clearly identify, label and segregate issuer materials from platform materials to ensure that Users will have no confusion about the source of the material
 - Clearly identify when communications between issuers and platform users are pre-offer "indications of interest" and when they are actual offers, which can only be made through the issuer's approved offering materials

Relevant SEC guidance

- Interpretive Release 33-7856 (Apr. 28, 2000) (the “Electronic Media Release”) did not relate to an electronic platform
- Release discussed whether hyperlinks to third-party information on an issuer’s website might cause the issuer to be liable for that third-party information under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder
- Relevant factors, “neither exclusive nor exhaustive,” that should be considered in assessing whether hyperlinked information would be attributable to an issuer, but not a “bright-line mechanical test”:
 - What does the issuer say about the hyperlink?
 - A strong positive statement by the issuer could be considered an endorsement (resulting in an adoption of the third-party information);
 - Even if the issuer is silent about the hyperlink, the context in which the issuer places the hyperlink may imply that the hyperlink is attributable to the issuer;

Relevant SEC guidance *(cont'd)*

- Third-party hyperlinks embedded in prospectuses should always be deemed an adoption by the issuer of the hyperlinked information; and
- A hyperlink in an issuer's website to information that constitutes an offer to sell gives rise to a strong inference that the issuer has adopted that information for purposes of Section 10(b) of the Exchange Act
- How can an issuer avoid adoption of third-party content available at a hyperlink in the issuer's website?
 - "If the issuer makes the information accessible only after a visitor to its web site has been **presented with an intermediate screen** that clearly and prominently indicates that the visitor is leaving the issuer's web site and that the information subsequently viewed is not the issuer's"
 - "Less likelihood of confusion about whether an issuer has adopted hyperlinked information if the issuer ensures that access to the information is **preceded or accompanied by a clear and prominent statement from the issuer disclaiming** responsibility for, or endorsement of, the information."

Relevant SEC guidance *(cont'd)*



Relevant SEC guidance *(cont'd)*

LANDING PAGE - You are now leaving content and analysis prepared by the platform operator; information on the next page, including offering documents, prospectuses and product terms, is prepared by the relevant issuer and provided to the platform operator for use on that page.

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Relevant SEC guidance *(cont'd)*

- A ***rough translation*** to electronic platforms:
 - Screens on a platform should be clearly identified as either issuer or platform content, by means of a clear and legible header or footer;
 - Avoid intermingling platform content and issuer content on a platform screen;
 - Platform content (such as educational materials and tools allowing platform users to “create” reverse inquiry notes) should include a statement that the issuer has neither reviewed, endorsed or approved the platform content and that the platform content is not an offer to sell, or a solicitation of an offer to purchase, any securities;
 - When a platform user is on a part of the electronic platform that is considered the platform’s content and then navigates away from the platform content to an issuer’s offering materials, the platform user should first encounter either (i) a landing page clearly spelling out that the platform user is leaving the platform content and going to the issuer content, and that the platform content is not part of the issuer’s offering documents, or (ii) a popup with the same content in the form of a clear and prominent disclaimer;

Relevant SEC guidance *(cont'd)*

- The reverse should be considered when leaving an issuer's offering materials and going to platform content; and
- Platform users should be clearly told that an offer of securities can only be made by means of an issuer's offering documents, and that any activities such as creating hypothetical or reverse inquiry notes and communications by issuers in response thereto are solely indications of interest and not offers.

FINRA communications rule

- How does FINRA's communication rule apply to other content, like educational materials or videos?
- Because the platform operator is a FINRA member, its communications to platform users are subject to FINRA Rule 2210 (Communications with the Public).
 - Platform content is an institutional communication, not subject to FINRA filing requirements
 - Under Rule 2210(d), platform content should be fair and balanced
 - It is good practice for a platform operator to submit a sampling of its educational videos to FINRA for review and comment, although not required by FINRA rules

Know your distributor and distribution arrangements

- Platform users will either be party to a distribution agreement with the issuer or a dealer agreement with the issuer's affiliated dealer
- Know your distributor issues will have been addressed through the use of these agreements
- For users that have no contractual relationship with either the issuer or its affiliated dealer, the platform operator may have an affiliated dealer that would act as an introducing broker

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Documenting a Relationship with a Platform Provider

User agreement for distributors

- A document setting out the requirements on, and rights of, the platform users and the platform operator. The provisions generally included are:
 - an explanation of the services provided by the platform;
 - acceptable use of the platform by the platform users;
 - no tampering with the platform, nor any fraudulent use of the platform;
 - network security conditions;
 - the platform owns its content;
 - ownership of trademarks and other intellectual property;
 - disclaimers (platform content not to be construed as advice or a solicitation or a recommendation to buy or sell a security);
 - no warranties, limitations on liability;
 - generalized representations and warranties by the platform users
 - platform users are dealers, RIAs or banks, and have proper licenses; and
 - indemnification, governing law and termination.

Issuer agreement for participants

- This is the main agreement between an issuer and/or its affiliated broker-dealer and the platform operator. Key provisions include:
 - Who is allowed access to the platform (dealers, RIAs and banks with investment discretion);
 - The issuer tells the platform operator who is eligible to access the Issuer's offering documents
 - Ownership of information on the platform
 - Which information is proprietary to the platform operator, and which information is owned by the issuer
 - Indemnification – each party indemnifies the other for misstatements and omissions
 - Issuer indemnifies for misstatements/omissions in its offering materials;
 - Platform operator indemnifies for misstatements/omissions in its content
 - Each party indemnifies the other for a breach of a representation, warranty or agreement in the agreement

Issuer agreement for participants *(cont'd)*

- Preserving confidentiality of proprietary or confidential information
- Representations, warranties and covenants:
 - Normal due organization, compliance with law, FINRA membership for the broker and the platform operator
 - Platform operator represents that it is not an underwriter
 - Platform operator represents that it is not giving investment advice
- Fees to be paid by the issuer; and
- Termination provisions.

Other considerations for issuers and affiliated broker-dealers

- Accessibility of the platform to the issuer's affiliated broker-dealer trading and structuring desk
- How will data be communicated by an issuer's affiliated broker-dealer to the platform?
- How will the issuer's affiliated broker-dealer respond to indications of interest and/or to reverse inquiries?
- Are most of the distributors using a single platform? Multiple platforms?
- Downtime and cybersecurity considerations
- Intellectual property considerations

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