



## SEC Provides Guidance on “General Solicitation” in C&DIs and No-Action Letter

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### Background

In general, all sales of securities must be registered pursuant to Section 5 of the Securities Act, unless the sale falls within a statutory exemption or safe harbor. Rule 506(b) of Regulation D is one such safe harbor, but it prohibits general solicitations and general advertisements.

### General Solicitation or General Advertisement

As affirmed by the SEC in its C&DIs, an offer of securities to a potential investor with whom the issuer or its agent has a “pre-existing, substantive relationship” does not constitute a general solicitation or general advertisement. The SEC provided the following guidance on the establishment of a pre-existing, substantive relationship:

- *Pre-Existing Relationship.* A “pre-existing” relationship is one that an issuer forms with a potential investor prior to commencing a securities offering. A pre-existing relationship can also be established by an issuer with a potential investor through a registered broker-dealer or investment advisor if the issuer established this relationship prior to the registered broker-dealer or investment advisor’s participation in the offering.
- *Substantive Relationship.* A “substantive” relationship exists when an issuer has sufficient information to evaluate a prospective investor’s financial circumstances and sophistication when determining such prospective investor’s status as an accredited or sophisticated investor. Importantly, the issuer must actually undergo the evaluation. It is insufficient for an issuer merely to collect such information without reviewing it.

Furthermore, self-certification by the prospective offeree is insufficient alone to form a substantive relationship between the issuer and the prospective offeree. Finally, the Staff considers the “quality” of an issuer’s relationship with a potential investor to be the “most important factor” in determining whether a substantive relationship exists.

## **The Citizen VC No-Action Letter**

Citizen VC uses an online venture capital investment platform to facilitate indirect investment by its members. As noted in C&DI Question 256.23, Rule 502(c) prohibits offerings through an unrestricted, publicly available website. The Citizen VC request letter sets forth the policies and procedures that Citizen VC employs to establish a pre-existing, substantive relationship, which provides a useful blueprint, even outside the context of websites, for other issuers wishing to rely on the Rule 506(b) safe harbor.

Importantly, after prospective investors complete generic online “accredited investor” questionnaires, Citizen VC then proceeds to a “relationship establishment period.” During this period, Citizen VC takes various actions to connect with the prospective investors and collect information to evaluate the prospective investor’s sophistication, financial circumstances, and ability to understand the nature and risks related to an investment.

Finally, after Citizen VC is satisfied that the prospective investor is sophisticated, and after taking all reasonable steps it believes necessary to create a substantive relationship, Citizen VC will then give the prospective investor access to password-protected sections of the website to investigate investment opportunities. Consistent with guidance from the Staff, this relationship exists prior to the commencement of any offering.

## **Additional Guidance from the Staff**

- *No Minimum Waiting Period.* To establish a pre-existing, substantive relationship, there is no minimum waiting period. Rather, the issuer must establish a relationship prior to the commencement of the offering; or, when the relationship is established through a registered broker-dealer or investment advisor, the relationship must be established prior to the time such registered broker-dealer or investment advisor began participating in the offering. Note that a limited accommodation exists for certain private funds making offerings on a semicontinuous basis, in which a waiting period may cleanse what would otherwise be considered a general solicitation.

- *Registered Investment Advisors.* A registered investment advisor's fiduciary duty to provide suitable investment advice to its clients would likely establish a pre-existing, substantive relationship, because, in fulfilling this duty, an advisor must make a reasonable determination that the investment advice provided is suitable for the client based upon the client's financial situation and investment objective.
- *Registered Broker-Dealers and Investment Advisors.* Depending on the facts and circumstances, third parties other than registered broker-dealers and investment advisors may be able to form a pre-existing, substantive relationship with a prospective investor. However, in the absence of a prior business relationship or a recognized legal duty to offerees, it is likely more difficult for an issuer to establish a pre-existing, substantive relationship, especially when contemplating or engaging in an offering over the Internet. In such circumstances, the Staff notes that Rule 506(c) would provide greater certainty regarding the availability of an exemption from registration.
- *Demo Days and Venture Fairs.* Whether a demo day or venture fair constitutes a general solicitation for purposes of Rule 502(c) is a facts-and-circumstances determination. For instance, if the presentation by the issuer involves an offer of a security, such presentation may not constitute a general solicitation if, for example, attendance is limited to persons with whom the issuer or the organizer has a pre-existing, substantive relationship or who have been contacted through an informal, personal network of individuals with experience investing in private offerings.
- *Factual Business Information.* An issuer can widely disseminate information not involving an offer of securities without violating Rule 502(c), including factual business information that does not condition the public mind or arouse public interest in an offering. Factual business information is typically limited to information about the issuer, its business, financial condition, products, services, or advertisement of such products or services, and generally does not include predictions, projections, forecasts or opinions with respect to valuation of a security. Also, for a continuously offered fund, it would not include information about past performance of the fund.

## Categories

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