Securities Bulletin

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Ohio | Department of Commerce

Division of Securities

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Cover Story

Registration Section Review of Issuer Advertising

The Ohio Division of Securities protects investors by reviewing and commenting on issuer advertising material prior to its use in Ohio, and by using its resources to prevent unreliable or misleading claims from reaching potential investors. This authority is established in section 1707.09(B)(4) of the Ohio Revised Code (O.R.C.), Ohio Administrative Code (O.A.C.) section 1301:6-3-06(C), and is a requirement of Item 8(j) of Form U-1, or Item 14(e) to the Form 6(A)(1).[1] In addition, we require issuers to confirm they will file advertisements with the Division prior to their use in Ohio as a condition of their registration.

Each piece of advertising material is different. So, it is impossible to exhaustively describe in advance how we would respond to every potential issue. The purpose of this article is to explain both the process and the principles we apply to the review. It is our hope this article provides regulated financial professionals with an expectation of the principles we apply when reviewing their submissions. We also hope this article will heighten investor awareness of issues

[1] Ohio Admin. Code 1301:6-3-06(C) and Ohio Rev. Code § 1707.09(B)(4) and Ohio Rev. Code § 1707.13.

surrounding investment advertising. As always, the Division encourages investors to rely upon the offering documents and to understand the risks of each investment.

I. Submission and Review of Advertisements

a. **Submitting Materials**. Issuers can submit advertisements by mailing or emailing the materials to the Division. Hard copies are typically preferable. Videos may be submitted by mailing a CD/DVD or by providing a website link. We will review the materials and may issue comments to the submitter, asking for clarification, explanation or by requesting changes. Because of this, issuers may want to postpone printing copies of their advertisement until the Division approves it for use in Ohio.

   Issuers should adhere to the following best practices:

   - **Identify the intended audience for the advertisement**. Issuers should indicate with whom the advertisement will be used. For example, if the material is for broker-dealer or for financial professionals only, be sure to indicate it. Any material identified as being for a specific audience must be accordingly limited in its use and may not be used with the general public.
   - **Indicate how the piece will be disseminated**. It can be helpful to understand how an issuer will use a piece. For example, if the advertisement is a slide show, we may inquire as to the audience of the presentation and ask if there are prepared remarks or a script. In such a case, we will also ask for the prepared remarks corresponding to the presentation and any invitation to the presentation.
   - **Submit materials in the format close to their actual intended use**. Issuers should be mindful certain black and white copies may not accurately display highlighted or enhanced colored text. As a result, we ask issuers to submit materials in the format in which they will be used.

b. **Receiving and Responding to Comments**. If an issuer receives comments from the Division, it may respond in one of two ways: it may resolve the comments, perhaps by revising the materials, or it may withdraw or limit the materials so they will not be used in Ohio.

   Issuers should address the substance of the comment regardless of whether similar material is in use by another issuer or has been approved by the Division in another piece. It is our position that a previous approval or comment resolution does not alter the issuer's duty to respond to a comment, and we will not take previous review into consideration.

   When submitting revisions in response to comments, we prefer to receive a line-by-line comparison (e.g., a redline) showing the changes made from any previous version. This can be helpful to understand the changes made and enables us to isolate and review the changed material. In some cases, we may raise issues in the revised submission we did not raise in our initial comment letter.

II. Advertising Standards.

The Division's standard of review is investor-focused and prohibits material that would tend to deceive investors. This standard is derived from the Division's authority to

suspend offerings pursuant to O.R.C. Section 1707.13.[2] The standard is stated, in part, as follows:

> *The Division may suspend a registration if it finds that the proposed offer or disposition is on grossly unfair terms or that the plan of issuance and sale of securities would defraud or deceive, or tend to defraud or deceive, purchasers.*

Stated otherwise, the Division protects investors by prohibiting advertising material that defrauds, deceives, or tends to defraud or deceive. The Division applies the following principles to its review of advertisements to uphold our standard:

- **May not make false, misleading or unreliable claims**. The Division will object when a piece contains misleading information or when the Division believes a piece's effect would be misleading to investors. An issuer should not make or imply a claim that is not true. An advertising piece may be misleading in its overall effect even though every sentence may be technically true.[3]
  Examples:
  - Claiming something to the effect of "every penny goes into our properties" or "all investments go to church loans" when the prospectus discloses the issuer has the discretion to make other investments.
  - Presenting an investment as a savings account or using terms that may confuse investors into thinking they are investing with a bank.
  - Prominently advertising growth and then explaining in a footnote the growth is achieved through borrowing.
  - Advertising that distributions are tax free or they reduce taxes when the distributions are, in fact, merely a return of capital.
  - Referring to an issuer as institutional (or "institutional-quality", etc.). Institutions invest on substantially different negotiated terms and conditions than retail investors, including terms relating to fees and expenses, leverage, and governance.
  - Stating the issuer is "transparent" when the issuer does not make periodic disclosures or has offering documents hundreds of pages in length.
  - Stating its "interests are aligned with shareholders" when the prospectus discloses substantial conflicts of interest, fees and expenses.

- **Must balance its presentation of risk and returns**. The Division considers it grossly unfair to advertise the potential benefit of an investment without also balancing

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[2] Note: Ohio Rev. Code § 1707.13 explicitly applies to registration by description and registration by qualification filings and is extended to registration by coordination filings by Ohio Rev. Code § 1707.01(Q)(3). Other grounds for not registering the securities exist under Ohio Rev. Code § 1707.09. Further, the prohibitions under Ohio Rev. Code § 1707.44 may extend to more serious advertising activities directed at Ohio residents.

[3] *e.g.*, *SEC v. Fitzgerald*, 135 F.Supp.2d 992, 1028 (N.D. Cal. 2001) (stating "[a]n Issuer cannot assert that its statements are not misleading merely because every sentence used throughout a statement is accurate and truthful in and of itself; *see also, SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106-07 (9th Cir. 1977) (finding advertisements were "deceptive and misleading in their overall effect even though when narrowly and literally read, no single statement of material fact was false").

disclosure of the corresponding risks.[4] Instead, issuers should also present risks in equal prominence in both placement and font size. Issuers sometimes bury disclosures of the risks associated with an investment at the very end of their advertising material, and frequently present it in smaller typeface with tighter spacing, which discourages investors from reading it. In practice, we evaluate the placement of many risk disclosures to the material to present an understanding of the investment and require the risks to be presented in equivalent proximity, font, size, color, and spacing as the rest of the material.

Example:

- Using phrases such as "The Road to Income" or the "Path to Prosperity." These statements imply a level of certainty not commensurate with the risks of many investments. We require such language be removed, revised or be accompanied (in equal prominence) by risk disclosures.

- **Advertisements should be relevant, material, and consistent with the disclosure provided in the prospectus.** So, if information is material, it should be neither buried in the footnotes nor excluded from the piece. Likewise, if information is irrelevant, we will question its inclusion as potentially misleading to investors.

  Example:

  - Issuers with no or limited operating history comparing themselves to industry benchmarks and averages in order to imply an investment in their security will yield similar performance. As there is no assurance the issuer's particular security will perform similarly to historical industry averages, the historical performance of other issuers is irrelevant to how the issuer will perform.

- **Issuers should make full and fair disclosure**. The Division frequently objects to pieces that fail to present an issue fully and fairly. To provide an example, if an issuer's prospectus discusses the complexity of its fee structure over the course of five pages, the issuer may not be able to capture fully and fairly disclose the issue in a website banner. Such use would fail to fully disclose the features of an investment.

  Examples:

  - Issuers should not discourage a thorough review of the offering circular. The Division objects to statements over simplifying a description of the features of an investment. For example, a piece should not say "Here's what you need to know" and then attempt to boil an offering circular down to a few bullet points.
  - Using charts and graphs to demonstrate the benefit of the issuer's security in a portfolio, often showing increased returns and decreased risk. We usually object to such claims as there is no assurance the issuer's particular security will perform similarly to its general asset class, or any investor's portfolio can be analogized to the model portfolio.

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[4] *See, e.g.,* Securities and Exchange Commission, *Securities Act Industry Guide 5* (2008) at 19A, available at https://www.sec.gov/about/forms/industryguides.pdf (stating: "[t]he sales material should present a balanced discussion of both risk and reward. The contents of the sales material or sales meetings or seminars should be consistent with the representations in the prospectus"). *See also*, Division of Corporate Finance, Securities and Exchange Commission, *Staff Observations in the Review of Promotional and Sales Material* (2011), available at https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic3.htm.

- Advertising one aspect of an offering without including additional relevant disclosure. The mere existence of prospectus disclosure does not guarantee the appropriateness of its inclusion in an advertising piece.
- Advertising tax benefits using hypotheticals assuming a tax bracket, distribution rate, an investment rate, a certain return or a level of investment. Many issuers fail to present fair and full disclosure on this issue. For example, we ask REITs advertising recent tax law changes to also state, at a minimum*:*
  - *The tax benefits are not applicable to capital gain dividends or certain qualified dividend income;*
  - *The tax benefit is only available for qualified REITs and whether the issuer is a qualified REIT and if the issuer's board is authorized to revoke its REIT election;*
  - *The tax benefit is set to expire in seven years from adoption;*
  - *There may be adverse legislative or regulatory tax changes;*
  - *Other investments may offer tax advantages without the set expiration;*
  - *An accelerated depreciation schedule does not guarantee a profitable return on investment; and*
  - *Return of capital as a reduction in the basis of the investment.*

- **Advertisements should be appropriate for intended audiences**. We will object to advertisements inappropriate for their intended audience.
  Examples:
  - A retail-use piece using complicated or overly nuanced information.
  - Advertising encouraging a suitability violation, or an investment would exceed concentration limits.

- **Comparisons present unique obstacles**. We routinely object to comparisons not containing all relevant differences and similarities. Most comparisons fall short of a meaningfully comparison. As a result, we typically object to comparisons between Issuers and asset classes.
  Example:
  - The Division will object if an issuer compares its performance to another investment type without disclosing and discussing all the differences between the two. Many products have too many differences to be meaningfully compared. In such cases, the comparison should be removed altogether.

- **Sources and third-party materials**. If an issuer relies on a source, it should provide a link to the source material. If the information is not publicly available, the advertisement should offer to provide the non-public material upon request. Issuers may be asked to disclose the fact the third-party endorsement or article may not be representative of other opinions, or articles, or literature. The Division will review claims made by third parties as if those claims were made by the issuer. Relatedly, we object to the use of non-public indexes in retail-use material.

- **Advertisements should adhere to restrictions in NASAA guidelines**. Certain NASAA guidelines have specific applications for advertisements. Issuers should be mindful of these guidelines and restrictions.

Example:

- The NASAA REIT guidelines prohibit advertisements from containing a quantitative estimate of a REIT'S anticipated economic performance or anticipated return to participants, in the form cash distributions or tax benefits.[5]

- **Reconcile non-GAAP metrics**. If an issuer advertises non-GAAP financial measures, it should accompany those measures with the closest corresponding GAAP measure and provide a quantitative reconciliation of the two. We wrote more extensively on this in the 2019:4 issue of the Ohio Securities Bulletin.[6]

- **Specific Issuer Types**. Finally, we object to certain claims frequently made by non-traded REITs and discussed these issues in the 2020:1 issue of the Ohio Securities Bulletin.[7] We may write about other specific advertising issues for other issuer types in future bulletin articles.

III. Conclusion.

One final word for both investors and issuers. Most prospectuses caution investors to rely solely on the offering circular and typically provide subscription agreements requiring purchasers to acknowledge or represent they have done so. These documents do not incorporate advertising and sales material. Investors are therefore put between a rock and a hard place; they can be attracted to an issuer by flashy and simplified advertisements and then defended against by complicated and nuanced disclosure in the prospectus. As a result, we strongly encourage investors to rely solely upon a prospectus and to understand the risks of any investment decision.

Issuers should also remember that the prospectus is and should be the main vehicle of each sale. In other words, securities offered in a registered offering may be sold in Ohio through the prospectus *regardless of whether an issuer produces advertisements.* While marketing material is often more attractive to view than a prospectus, it must be viewed in light of the disclosures in the prospectus and is only appropriate to the extent it does so.

If you have specific questions regarding any of the topics discussed in this article, contact the Registration Section at 614-466-4375.

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[5] North American Securities Administrators Administration, *Statement of Policy Regarding Real Estate Investment Trusts*, (May 7, 2007), available at https://www.nasaa.org/wp-content/uploads/2011/07/g-REITS.pdf, at VII.B.3.
[6] Div. Reg. Staff, Non-GAAP Measures in Advertising, OHIO SECURITIES BULL. 2019:4 at 15, available at https://www.com.ohio.gov/documents/secu_Bulletin2019FourthQuarter.pdf.
[7] Div. Reg. Staff, *Private Indexes in Advertising and Non-Traded REIT Valuations,* OHIO SECURITIES BULL. 2020:1 at 3, available at https://www.com.ohio.gov/documents/secu_Bulletin2020FirstQuarter.pdf.