Contract Cloud for Crowdfunding Platforms

How does Contract Cloud support Rule 506 of Regulation D?

Crowdfunding platforms are allowed to sell securities to "accredited investors" in accordance with Rule 506 of Regulation D ("Reg D") under Section 4(a)(2) of the Securities Act of 1933. Contract Cloud helps crowdfunding platforms comply with Sections 506(b) and 506(c) by implementing a video attestation process during investor profile creation. The patent-pending system ensures the video is authentic, while maintaining investor privacy and platform security.

How does Contract Cloud support 506(b) offerings?

Under 506(b), crowdfunding platforms may sell securities to "accredited investors" who self-verify their accreditation and certain "sophisticated" non-accredited investors. The purpose of these regulations is to limit investment opportunity to individuals with sufficient knowledge, wealth, general intelligence and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment.

Crowdfunding platforms require investors to simply click a box to attest that they are either accredited or sophisticated. Some platforms even require prospective investors to answer multiple choice questions during investor profile creation to demonstrate sophistication. Contract Cloud’s API easily integrates with both of these scenarios. The investor clicks “I agree” or completes the sophistication quiz, which is quickly followed by their video attestation. Contract Cloud does not require the user to ever leave the platform’s workflow. The video attestation can again be used at the point of investment when the investor clicks his/her acknowledgment of the terms and conditions of the investment.

Once an investor is portrayed as "sophisticated," he/she has the potential to diminish the burden crowdfunding platforms must meet to establish the investor was provided with a suitable investment recommendation. The recording demonstrates the investor has an appropriate level of knowledge and adequate understanding to be capable of evaluating the risks associated with investing. Contract Cloud’s video attestation will enforce the validity of the investor’s investment objectives, financial needs and other customer based considerations.

How does Contract Cloud support 506(c) offerings?

Under 506(c), crowdfunding platforms can broadly solicit and generally advertise investment offerings if the investors are all accredited investors. The crowdfunding platform must also take reasonable steps to verify that the investors are all accredited investors.

As defined in Rule 501 of Reg D, the term accredited investor means any person who meets a defined minimum income and net worth. Certain states also set forth more strict definitions of

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the qualifications for an accredited investor. Further, the crowdfunding platform must reasonably believe the investor meets the required criteria at the time of the sale of the securities to the investor.

Contract Cloud helps companies verify and validate the accuracy of the information provided by potential investors in order to prove accreditation and prevent fraud. Identity verification and information accuracy can be confirmed during the creation of the investor profile through Contract Cloud’s video attestation service. Contract Cloud can also capture investors’ stated intent to make the investment at issue as well as their capacity. Contract Cloud provides a layer of protection for the crowdfunding platform to demonstrate to regulators that it is using all means available to ensure the accreditation of the investor is verified.

**How does Contract Cloud support FINRA Suitability Rule 2111?**

Under FINRA Rule 2111, crowdfunding platforms must have a reasonable basis to believe that their recommended or “promoted” investment transactions are suitable for their investors. The three customer obligations for crowdfunding platforms under Rule 2111 that can be validated with video attestation are: customer-specific suitability, quantitative suitability and financial ability.

The customer-specific suitability obligation requires the crowdfunding platform to have a reasonable basis to believe that the promoted investment is suitable for a particular investor based on his/her investment profile. This assessment is based on the information obtained through reasonable diligence to ascertain the customer’s investment profile. Crowdfunding platforms can further demonstrate the validity of the information in review by requiring the investors to attest to the information they provided in their profile.

Quantitative suitability obligations require crowdfunding platforms to have a reasonable basis for believing that a series of promoted transactions are not excessive and unsuitable for the investor when taken together in light of his/her investment profile. Video attestation on the accuracy of the information provided by the investor during the profile creation is a pre-validation method implemented prior to checking the finances of the investor. If the investor becomes over-concentrated in investments on the platform, then video attestation can be used to capture the investor’s understanding of the risks associated with their investment.

Rule 2111 prohibits crowdfunding platforms from recommending a transaction or investment strategy involving a security or the continuing purchase of securities unless the crowdfunding platform has a reasonable basis to believe that the investor has the financial ability to meet such a commitment. Video attestation is a vital verification step to investor profile creation and/or investor disclosure process prior to running full financial checks.

For more information on FINRA Rule 2111, please review the current manual updated May 2014.