Financial Industry Regulatory Authority

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January 12, 2021

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Email to rule-comments@sec.gov

Re: File No. SR-FINRA-2020-038 -- Proposed Amendments to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) That Would Require Members to File Retail Communications Concerning Private Placement Offerings That Are Subject to Those Rules' Filing Requirements

Dear Ms. Countryman:

This letter is being submitted by Financial Industry Regulatory Authority, Inc. ("FINRA") in response to comments received by the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing. The proposed rule change would amend FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) to require members to file retail communications concerning private placement offerings that are subject to those rules' filing requirements.

The Commission published the proposed rule change for public comment in the Federal Register on November 6, 2020.[1] The Commission received five comment

[1] See Securities Exchange Act Release No. 90302 (November 2, 2020), 85 FR 71120 (November 6, 2020) (Notice of Filing of File No. SR-FINRA-2020-038).

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letters directed to the rule filing.[2] Two commenters supported the proposal.[3] NCPSC expressed support for the proposal but requested guidance concerning the application of FINRA Rule 2210 (Communications with the Public) to issuer-prepared materials. Scopus supported the proposal and suggested three additional rule changes concerning private placements. EquityZen expressed concerns with the proposal and suggested specified modifications.

The following are FINRA's responses to these comments.

Support for the Proposal

NASAA, NCPSC, PIABA and Scopus all supported the proposal and did not recommend any changes to the proposal's rule text. NASAA noted that its state securities administrator members have observed significant, recurring problems with private placements and stated that, "[w]ith the SEC's recent regulatory changes to the private offering marketplace, … the need for increased regulatory scrutiny of private placement advertisements is even more acute." PIABA stated that, because the numbers of persons who can invest in private placements has increased substantially over the last several decades, "FINRA must keep an eye [on] private placement sales abuses."

NCPSC noted that FINRA and SEC rules already require members to keep detailed records on marketing materials which are routinely requested during cycle examinations, and that the rule changes could facilitate this review process. Scopus stated that the proposed amendments are justified because, "FINRA will better ensure

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2 See Letter from Atish Davda, Co-Founder and Chief Executive Officer, Phil Haslett Co-Founder and Chief Revenue Officer, and Chris Giampapa, General Counsel, EquityZen Inc., to Vanessa Countryman, Secretary, SEC, dated December 4, 2020 ("EquityZen"); Letter from Lisa Hopkins President, General Counsel and Senior Deputy, Commissioner, North American Securities Administrators Association, Inc., to Vanessa Countryman, Secretary, SEC, dated November 24, 2020 ("NASAA"); Letter from James Dowd, North Capital Private Securities Corp. and Public Brokers, LLC, to Vanessa Countryman, Secretary, SEC, dated November 23, 2020 ("NCPSC"); Letter from David Meyer, President, Public Investors Advocate Bar Association, to Vanessa Countryman, Secretary, SEC, dated November 27, 2020 ("PIABA"); and Letter from Thomas Selman, Founder, Scopus Financial Group, to Vanessa Countryman, Secretary, SEC, dated November 22, 2020 ("Scopus").

3 See NASAA and PIABA.

that retail communications used by broker-dealers in retail private placements are fair, balanced and not misleading."

Issuer-Prepared Material

NCPSC requested that the SEC use this opportunity to provide "definitive guidance" to members with respect to the applicability of Rule 2210 to materials prepared and disseminated by an issuer to the public, without the involvement of a member firm or its registered representatives. FINRA cannot speak for the Commission in terms of the applicability of its rules or its interpretations of the federal securities laws. However, FINRA has already addressed the applicability of Rule 2210 to issuer-prepared communications.

In this regard, FINRA recently published Regulatory Notice 20-21 (July 2020), which provides guidance on retail communications concerning private offerings.[4] Quoting Regulatory Notice 10-22 (April 2010), Regulatory Notice 20-21 stated "sales literature concerning a private placement that a [member firm] distributes will generally be deemed to constitute a communication by that [member firm] with the public, whether or not the [member firm] assisted in its preparation."[5] In this regard, Rule 2210 prohibits members from publishing, circulating or distributing "any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."[6]

With respect to private placement memoranda (PPMs), Regulatory Notice 20-21 also quoted Regulatory Notice 10-22 and stated that "[a member firm] that assists in the preparation of a private placement memorandum or other offering document should expect that it will be considered a communication with the public by that [member firm] for purposes of … Rule 2210, FINRA's advertising rule." Such communications are subject to Rule 2210's content standards, including its requirements that communications be fair and balanced and not misleading. Whether a member firm

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4 FINRA Rule 2210(a)(5) defines a "retail communication" as any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period. A retail investor is any person other than an institutional investor, regardless of whether the person has an account with a FINRA member. See FINRA Rule 2210(a)(6).

5 Effective February 4, 2013, communications previously defined as "sales literature" under NASD Rule 2210 (Communications with the Public) fell within the definition of "retail communication" in FINRA Rule 2210. See Regulatory Notice 12-29 (June 2012).

6 See FINRA Rule 2210(d)(1)(B) (emphasis added).

participates in the preparation or distribution of offering material will always be based on the facts and circumstances surrounding the communication.

Regulatory Notice 20-21 also observed that some issuer-prepared PPMs are bound or presented as one electronic file with retail communications containing marketing or promotional content, such as cover pages or exhibits. Regardless of whether a member firm distributes a retail communication that is attached to a PPM or as a standalone document, it constitutes a member communication subject to Rule 2210.

Projections of Performance

NCPSC also requested that the SEC provide clear interpretive guidance under Securities Exchange Act ("Exchange Act") Rule 10b-5 concerning the inclusion of performance return objectives in private offering sales materials. Because of Rule 2210's restrictions on predicting or projecting performance, NCPSC argued that broker-dealers are placed at a competitive disadvantage relative to private offerings that do not involve a broker-dealer, and that the SEC should "level the playing field."

Subject to specified exceptions,[7] Rule 2210(d)(1)(F) prohibits member communications from predicting or projecting performance or making any exaggerated or unwarranted claim, opinion or forecast. As discussed in Regulatory Notice 20-21, retail communications concerning private placements may not project or predict returns to investors such as yields, income, dividends, capital appreciation percentages or any other future investment performance.[8]

However, FINRA does allow retail communications concerning private placements to include reasonable forecasts of issuer operating metrics (e.g., forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position. These presentations should provide a sound basis for evaluating the facts, such as clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede achievement of the forecasted metrics.[9]

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[7] There are four exceptions from the prohibition on projections: hypothetical illustrations of mathematical principles, investment analysis tools, price targets in research reports, and specified projections concerning security futures and options. See FINRA Rules 2210(d)(1)(F), 2215(b)(3), and 2220(d)(3).

[8] See Regulatory Notice 20-21 at page 4.

[9] Id. In 2017, FINRA solicited comment on proposed amendments to Rule 2210 that would create an exception to the rule's prohibition on projecting

Suggested Rule Changes

Scopus recommended that FINRA "adopt other bold measures to protect retail investors in the private placement market." First, Scopus recommended that FINRA combine Rules 5122 and 5123 into a single rule governing retail distribution of private placements by member firms. Scopus called the existence of two rules "an historical anomaly," noting that the adoption of Rule 5122, which concerned member private offerings, paved the way for Rule 5123, which applies to non-affiliated retail private placements. Scopus noted that the two rules confuse members and that it is more sensible to combine the rules.

Second, Scopus recommended that FINRA retain at least one requirement from Rule 5122 in the combined new rule: disclosure about the use of offering proceeds, offering expenses and selling compensation. Scopus noted that FINRA originally proposed to require these disclosures in Rule 5123 but dropped them before the SEC approved the rule. Scopus noted that this requirement is justified given the history of problems in the private placement market since FINRA adopted Rule 5123, since it would ensure investors get certain key information about an offering.

Third, Scopus recommended that FINRA amend Rule 2210 so that it applies to PPMs, term sheets and other offering documents in retail private placements. Scopus noted that since there is no legal definition (or even common understanding) of "private placement memorandum," it is difficult to distinguish a PPM from other retail communications, and it may be difficult to determine if a member assisted in the preparation of a PPM. Accordingly, Scopus suggests that such offering documents be subject to the general content standards of Rule 2210(d)(1).

FINRA appreciates these suggestions and the thinking behind them. Given that they are beyond the scope of this proposed rule change, however, FINRA does not believe it can adopt these proposed rule changes as part of this rule filing.

Scopus also had two suggestions for the Commission. First, it recommended that the SEC require private placement issuers to disclose, at a minimum, the use of offering proceeds and the offering expenses associated with the offering, and require

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performance to permit a member to distribute a customized hypothetical investment planning illustration that includes the projected performance of an asset allocation or other investment strategy, but not an individual security, subject to specified conditions. See Regulatory Notice 17-06 (February 2017). FINRA is still considering potential amendments to the prohibition of projections as part of these or future proposed rule amendments.

that issuer-prepared PPMs, term sheets, offering documents, and retail communications be filed for review.

Second, Scopus suggested that the Commission's regulation of private placements under the Securities Act of 1933 (Securities Act) recognize that the SEC and FINRA regulate the retail distribution of private placements by broker-dealers, including Regulation Best Interest's requirement that a broker-dealer must act in a retail customer's best interest when making a recommendation of any securities transaction or investment strategy involving securities,[10] requirements to conduct reasonable due diligence before recommending a private placement, and the filing requirements of FINRA Rules 5122 and 5123. Scopus suggested that the Commission scale the Securities Act protections afforded to retail investors according to whether a private placement is distributed by a broker-dealer. For example, the SEC could adopt a stricter definition of "accredited investor" under Securities Act Regulation D[11] when a private placement will be sold directly by an issuer. Since these comments are directed to the Commission and not to FINRA, FINRA does not believe that it needs to respond to these comments.

Non-Promotional Communications

EquityZen stated that it understands FINRA's concerns about issues it has seen in the private placement market and its desire to exercise greater oversight of retail communications in this market. Nevertheless, EquityZen feared that the proposed amendments as drafted could impose significant burdens on member firms engaging in private placements and unduly limit retail investment in, and access to, private offerings.

EquityZen argued that the current investor protection framework is robust, with overlapping oversight by the SEC, FINRA and the states. It submitted that it would be appropriate for the SEC and FINRA to assess the impact of Regulatory Notice 20-21 before deciding the extent to which further potentially costly measures are required. In the alternative, EquityZen proposed that Rule 5123 be modified to require members to file only "those types of communications on which investors are likely to base an investment decision," such as pitch decks or slide shows. EquityZen is concerned that unless the proposed rule text is narrowed, "retail communications concerning a private placement" could require members to file communications that are administrative in nature, such as confirmations that a signature was received or reminders of actions that investors still need to take.

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[10] See 17 CFR 240.15*l*-1.

[11] See 17 CFR 230.500.

FINRA agrees that the purpose of the proposed rule change is to give FINRA staff more immediate access to promotional and other marketing communications directed to retail investors, and not to require the filing of purely administrative and other non-promotional materials. We also note that some of the types of communications that EquityZen discusses in its comment letter likely would be directed to a single or small group of investors, and thus would be correspondence (which is not subject to filing) rather than retail communications.[12]

Nevertheless, FINRA recognizes that some of these administrative and non-promotional communications may fall within the definition of retail communication because they are distributed to more than 25 retail investors within a 30-day period. Accordingly, FINRA proposes to amend the proposed rule text of Rules 5122 and 5123 to require the filing of any retail communication that "promotes or recommends" a member private offering (Rule 5122) or private placement (Rule 5123), rather than a retail communication "concerning" such offerings. FINRA believes that this change will address EquityZen's concerns that as written, the rule change would require members to file numerous non-promotional communications with FINRA.[13]

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12 "Correspondence" means any written (including electronic) communication that is distributed or made available to 25 or fewer retail investors within any 30 calendar-day period. See Rule 2210(a)(2). In contrast, "retail communication" means any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period. See Rule 2210(a)(5).

13 FINRA uses similar rule text in Rule 2210's filing requirements for retail communications that promote registered investment companies. See Rule 2210(c)(3)(A) ("retail communications that promote or recommend a specific registered investment company or family of registered investment companies"). Rule 2210 also excludes from filing retail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member. See Rule 2210(c)(7)(C).

FINRA believes that the foregoing responds to the material issues raised by the commenters to the rule filing. If you have any questions, please contact me at (240) 386-4534, email: joe.savage@finra.org.

Best regards,

/s/ Joseph P. Savage

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