



# 2022 Annual Conference

May 16 –18 | Washington, DC | Hybrid Event

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## Trends and Developments in Private Placements

**Tuesday, May 17, 2022**

**11:00 a.m. – 12:00 p.m.**

This session focuses on industry and regulatory developments related to private placements. During the session, panelists discuss common concerns and recent regulatory findings. Speakers provide practical information and compliance tips for firms offering these products and discuss *Regulatory Notice 21-10*.

**Moderator:** Minh Le  
Director, Private Placements  
FINRA Corporate Financing

**Panelists:** Kimberly Flanders  
Associate Director  
FINRA Advertising Regulation

Tyler Gray  
President  
MicroVentures Marketplace Inc.

Scott Maestri  
Director, Retail Firm Examinations  
FINRA Member Supervision

## Trends and Developments in Private Placements Panelists Bios:

Moderator:



**Minh Q. Le** is Director of FINRA's Corporate Financing Department. He has more than 20 years of experience in the regulation of public and private offerings. Currently, Mr. Le manages the department's Private Placement Review program which conducts regulatory oversight of broker-dealer participation in retail private offerings. In addition to overseeing the review and investigation program, Mr. Le's duties include developing policy and providing guidance on corporate financing and other capital-raising related issues. Mr. Le also routinely provides subject matter expertise to FINRA's Examination and Enforcement staffs. Building on this experience, Mr. Le serves as a member on FINRA's Regulatory Specialist committees for Public Offerings, Private Placements, and Non-traded Direct Participation Programs (DPP) and Real Estate Investment Trusts (REIT), and was a member of FINRA's Risk Assessment Committee. For the past 19 years, he has been a member of FINRA's Sales Rep and DPP/REIT Qualifications Committees. Prior to his involvement in developing FINRA's private placement rules and the filing program, Mr. Le was a manager in the department's Public Offerings Review program, which is responsible for regulating underwriting terms and arrangements in public offerings. Mr. Le graduated from the University of Maryland, attended the Wharton Institute of Executive Education, and is a Certified Regulatory and Compliance Professional (CRCP)<sup>®</sup>.

Panelists:



**Kimberly Flanders** is Associate Director in FINRA's Advertising Regulation Department. Her chief responsibility is managing staff members dedicated to the review of matters involving complex products and novel regulatory concerns. Ms. Flanders joined FINRA (f/k/a NASD) in March 1995 as an examiner in the Enforcement Department. She joined the Advertising Regulation Department in March 1996. In January 2001, Ms. Flanders joined Bisys Services as a senior advertising regulation consultant. Ms. Flanders returned to the Advertising Regulation Department in September 2001. Prior to joining FINRA, she was an investigator with the Resolution Trust Corporation. Ms. Flanders received a B.A. from the University of Georgia.



**Tyler Gray** is President of MicroVenture Marketplace Inc., an alternative investment platform democratizing the private markets. He is responsible for the Firm's strategic direction, vision, growth, and performance. In his previous role with the firm, he was the Chief Operating Officer overseeing back-office operations, platform development, marketing, and finance. He has been with the firm since 2013 and has also previously served as the firm's Chief Compliance Officer. He holds a BA in Economics from Michigan State University and an MBA with a concentration in Accounting from St. Edward's University. Additionally, he holds the Series 7, 9, 10, 24, 27, 63 and 99 licenses.



**Scott H. Maestri** is Examination Director located in FINRA's Dallas Office. He began his career with NASD in 1999 as an examiner in the New Orleans District Office. Mr. Maestri was promoted to management in September of 2003 and became responsible for a team of examiners who monitored member firms through cycle and cause investigations, as well as, the Membership Application Process and Financial Surveillance. Mr. Maestri was promoted to the Associate District Director position in May of 2010 where his primary responsibility was the review and approval of the District Office's major program areas. Beginning in 2020, Mr. Maestri's role changed to focus on leading a team of four managers and 20 examiners located throughout the country who are responsible for conducting examinations of firms with a retail business model. Prior to NASD, Mr. Maestri worked in a variety of sales, operational, and compliance roles with both Morgan Stanley and Legg Mason in the Jackson, Mississippi branch office locations. During the course of his career, Mr. Maestri has been selected for Advanced Management training, and successfully obtained the Certified Regulatory and

Compliance Professional™ (CRCP™) designation both issued through The Wharton School at the University of Pennsylvania. Mr. Maestri received his B.B.A. in Finance from The Elise School of Management at Millsaps College.

# Trends and Developments in Private Placements

# Panelists

## ○ Moderator

- Minh Le, Director, Private Placements, FINRA Corporate Financing

## ○ Panelists

- Kimberly Flanders, Associate Director, FINRA Advertising Regulation
- Tyler Gray, President, MicroVentures Marketplace Inc.
- Scott Maestri, Director, Retail Firm Examinations, FINRA Member Supervision



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## **Trends and Developments in Private Placements**

**Tuesday, May 17, 2022**

**11:00 a.m. – 12:00 p.m.**

### **Resources:**

- FINRA Frequently Asked Questions Related to Filing Requirements of Rules 5122 and 5123

[www.finra.org/rules-guidance/guidance/faqs/finra-rules-5122-5123](http://www.finra.org/rules-guidance/guidance/faqs/finra-rules-5122-5123)

- FINRA Frequently Asked Questions on Rule 2210

[www.finra.org/rules-guidance/guidance/faqs/advertising-regulation](http://www.finra.org/rules-guidance/guidance/faqs/advertising-regulation)

# Regulatory Notice

20-21

## Communications With the Public

### FINRA Provides Guidance on Retail Communications Concerning Private Placement Offerings

#### Summary

This *Notice* provides guidance to help member firms comply with FINRA Rule 2210, Communications with the Public, when creating, reviewing, approving, distributing, or using retail communications concerning private placement offerings.

Questions concerning this *Notice* should be directed to:

- ▶ Amy C. Sochard, Vice President, Advertising Regulation, at (240) 386-4508; or
- ▶ Ira D. Gluck, Director, Advertising Regulation, at (240) 386-4614.

#### Background and Discussion

##### Private Placement Offerings

Private placements are unregistered, non-public securities offerings that rely on an available exemption from registration with the Securities and Exchange Commission (SEC) under either Sections 3 or 4 of the Securities Act of 1933 (Securities Act).<sup>1</sup> Most private offerings, however, are sold pursuant to one of three “safe harbors” under Rules 504, 506(b), and 506(c) of Securities Act Regulation D (Reg D).<sup>2</sup>

Reg D requires companies and funds to file a Form D through the SEC’s EDGAR system when selling unregistered securities based on a claimed Reg D exemption. The most recent Reg D data published by the SEC’s Division of Economic and Risk Analysis indicates that issuers make approximately 20,000 new offering Reg D filings with the SEC each year.<sup>3</sup> Of this total, approximately 4,000 new offerings identify an “intermediary,” such as a broker or finder, as participating in an offering.

Private placements sold by FINRA member firms to individuals generally must be filed with FINRA. In this regard, FINRA Rules 5122 and 5123 require a member firm to file offering documents regarding specified private placements in which the member firm participates.<sup>4</sup> FINRA receives

July 1, 2020

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Advertising
- ▶ Compliance
- ▶ Corporate Financing
- ▶ Legal
- ▶ Operations
- ▶ Registered Representatives
- ▶ Senior Management

#### Key Topics

- ▶ Communications with the Public
- ▶ Private Placements
- ▶ Retail Communications

#### Referenced Rules

- ▶ FINRA Rule 2210
- ▶ Regulation D
- ▶ Regulatory Notice 10-22
- ▶ Regulatory Notice 13-18
- ▶ Regulatory Notice 19-31

approximately 2,000 new offering filings from its member firms each year,<sup>5</sup> and uses analytics and trained analysts to conduct a risk-based review of each filing. The number of annual filings with FINRA indicates that approximately half of the Reg D filings identifying intermediaries are for offerings by entities that are not subject to FINRA rules or offerings by member firms that are not required to file under Rules 5122 or 5123.

The offerings that are sold directly by issuers or through the efforts of intermediaries that are not FINRA member firms are not subject to the regulatory requirements applicable under FINRA rules and are not subject to FINRA's examination and review programs. Although FINRA does not have jurisdiction over Reg D private placements that are sold directly to investors or through non-member firm intermediaries, it is committed to promoting investor protection through meaningful regulation and oversight of member firms participating in these offerings.

The remainder of this *Notice* addresses the subset of private placements conducted by member firms.

### Private Placement Retail Communications

Many private placement offerings to retail investors include marketing or sales communications that meet the definition of retail communication in Rule 2210(a)(5).<sup>6</sup> For example, FINRA has observed that more than 40 percent of the offerings filed pursuant to FINRA Rule 5123 include retail communications. In addition, the adoption of Rule 506(c) under Reg D eliminated the prohibition against general solicitation and advertising for private placement offerings where all purchasers of the securities are verified accredited investors. Consequently, member firms have become increasingly involved in the distribution of private placement securities through online platforms and other widely disseminated communications such as digital advertisements.<sup>7</sup>

FINRA Rule 2210(d)(1) requires that all member firm communications be fair, balanced and not misleading. Communications that promote the potential rewards of an investment also must disclose the associated risks in a balanced manner.<sup>8</sup> In addition, communications must be accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed. Rule 2210(d)(1) also prohibits false, misleading or promissory statements or claims, and prohibits the publication, circulation or distribution of a communication that a member firm knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. With few exceptions, Rule 2210(b)(1) requires that an appropriately registered principal approve each retail communication before the earlier of its use or filing with FINRA's Advertising Regulation Department.<sup>9</sup>



Recent FINRA reviews of retail communications concerning private placements have revealed deficiencies. For instance, most if not all investments in private placements are illiquid, and many such investments are speculative in nature. Some retail communications do not balance claims of these investments' benefits by disclosing these risks. Others have contained false, misleading, or promissory statements or claims such as assertions about the likelihood of a future public offering of the issuer, claims about the future success of the issuer's new or untried business model, inaccurate or misleading assertions concerning the regulation or relative risk of the offering, or predictions or projections of investment performance prohibited by FINRA Rule 2210(d)(1)(F).

FINRA is providing the following guidance to assist member firms in their creation, review, approval, distribution or use of retail communications concerning private placement securities.

### Third-Party Prepared Materials

Rule 2210(a)(5) defines "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."<sup>10</sup> FINRA disciplinary actions demonstrate that member firms can be liable for violations of Rule 2210 when distributing or using noncompliant retail communications prepared by a third party.<sup>11</sup>

[Regulatory Notice 10-22](#) states 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. If a private placement memorandum or other offering document presents information that is not fair and balanced or that is misleading, then the [member firm] that assisted in its preparation may be deemed to have violated ... Rule 2210." *Notice 10-22* also provides that "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."

In addition, FINRA has observed that some issuer-prepared private placement memoranda (PPMs) are bound or presented as one electronic file with retail communications, such as cover pages or exhibits. Such retail communications are distinguishable by their marketing or promotional content from the factual descriptions and financial information about the issuer generally disclosed in the PPMs. Regardless of whether a member firm distributes a retail communication that is attached to a PPM or as a standalone document, it constitutes a communication of the member firm subject to Rule 2210.

### Balanced Presentation of Risks and Investment Benefits

Rule 2210 requires communications that discuss the benefits of an investment also to include a discussion of its risks.<sup>12</sup> As indicated above, retail communications that discuss the potential benefits of investing in private placements should balance this discussion with disclosure of their risks, such as the potential for private placement investments to lose value, their lack of liquidity and their speculative nature. Providing risk disclosure in a separate document, such as a PPM, or in a different section of a website does not substitute for disclosure contained in or integrated with retail communications governed by Rule 2210.

Retail communications often highlight the business of the issuer and discuss the value proposition of a potential investment. In such cases, the key risks associated with an investment in the issuer are necessary in order to balance the positive portrayal of the investment. For example, when the issuer is a startup company, the risks may include a limited track record; more experienced or larger competitors; overreliance on financing; reliance on a single supplier, customer or employee; or lack of management experience.

### Reasonable Forecasts of Issuer Operating Metrics

Rule 2210(d)(1)(F) generally prohibits the use of any prediction or projection of performance, as well as any exaggerated or unwarranted claim, opinion or forecast.<sup>13</sup> Accordingly, 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.

However, FINRA would not consider 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 to be inconsistent with the rule. Presentations of reasonable forecasts of issuer operating metrics should provide a sound basis for evaluating the facts as required by Rule 2210(d)(1)(A). For example, such presentations should include clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede the issuer's achievement of the forecasted metrics.

When creating, reviewing, approving, distributing or using forecasts of issuer operating metrics in retail communications, member firms should consider:

- I. the time period forecasted (generally a time period in excess of five years would be unreasonable);
- II. whether growth rate assumptions are commensurate with the nature and scale of the business;
- III. whether forecasted gross margins<sup>14</sup> are commensurate with industry averages; and
- IV. whether sales and customer acquisition forecasts are reasonable in relation to the overall market for the issuer's products or services.

While sources of contractual revenue such as royalty or master lease agreements may inform or provide a basis for reasonable forecasts of issuer operating metrics, it would be inconsistent with Rule 2210(d)(1)(B) to characterize specific revenue or cash flow as guaranteed or certain. Moreover, Rule 2210(d)(1)(F) precludes member firms from using the data from forecasts of issuer operating metrics to project or depict specific investment returns to an investor.

### Distribution Rates

[Regulatory Notice 13-18](#) provided guidance to member firms regarding communications with the public for registered and unregistered real estate investment programs. Given that some non-real estate private placement investments employ similar structures, the principles relating to distribution rates contained in that *Notice* are applicable to retail communications regarding private placement investments designed to provide distributions to investors and are reiterated below.

Some issuers fund a portion of their distributions through return of principal or loan proceeds. For example, a portion of a newer program's distributions might include a return of principal until its assets are generating significant cash flows from operations. Consistent with Rule 2210(d)(1)(B)'s prohibition of false, exaggerated, unwarranted, promissory or misleading claim, member firms must not misrepresent the amount or composition of such distributions. Nor may member firms state or imply that a distribution rate is a "yield" or "current yield" or that investment in the program is comparable to a fixed income investment such as a bond or note. Presentations of distribution rates consistent with Rule 2210 would disclose:

- ▶ that distribution payments are not guaranteed and may be modified at the program's discretion;
- ▶ if the distribution rate consists of return of principal (including offering proceeds) or borrowings, a breakdown of the components of the distribution rate showing what portion of the quoted percentage represents cash flows from the program's investments or operations, what portion represents return of principal, and what portion represents borrowings;
- ▶ the time period during which the distributions have been funded from return of principal (including offering proceeds), borrowings or any sources other than cash flows from investment or operations;
- ▶ if the distributions include a return of principal, that by returning principal to investors, the program will have less money to invest, which may lower its overall return; and
- ▶ if the distributions include borrowed funds, that since borrowed funds were used to pay distributions, the distribution rate may not be sustainable.<sup>15</sup>

FINRA believes that it is inconsistent with Rule 2210(d)(1) for retail communications to include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods.<sup>16</sup>

### Internal Rate of Return

Internal Rate of Return (IRR) is a measure of performance commonly used in connection with marketing private placements of real estate, private equity and venture capital. IRR shows a return earned by investors over a particular period, calculated on the basis of cash flows to and from investors (*i.e.*, the percentage rate earned on each dollar invested for each period the dollar was invested). IRR is calculated as the discount rate that makes the net present value of all cash flows from an investment equal to zero.<sup>17</sup>

A drawback of IRR calculations is their inherent assumption that investors will be able to reinvest any distributions from the investment at the IRR rate. In practice, it is unlikely that this would occur. Another drawback is that in order to calculate IRR for a portfolio that includes holdings that have not yet been sold (or otherwise liquidated or matured), a valuation of those remaining assets must be estimated. Depending on the nature of the asset, these estimated values may be based on subjective factors and assumptions.

The use of IRR in retail communications concerning privately placed new investment programs that have no operations or that operate as a blind pool would be inconsistent with the prohibition on unwarranted forecasts or projections in Rule 2210(d)(1)(F).

Nevertheless, FINRA interprets Rule 2210 to permit retail communications to include IRR for completed investment programs (*e.g.*, the holding matured or all holdings in the pool have been sold). In addition, FINRA does not view as inconsistent with the rule retail communications that provide an IRR for a specific investment in a portfolio if the IRR represents the actual performance of that holding.

Investment programs such as private equity funds and REITs may have a combination of realized investments and unrealized holdings in their portfolios. Where the program has ongoing operations, FINRA interprets Rule 2210 to permit the inclusion of IRR if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS) adopted by the CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors.<sup>18</sup>

## Endnotes

1. See 15 U.S.C. 77c and 77d.
2. See 17 CFR 230.504, 230.506(b) and 230.506(c).
3. *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017*: <https://www.sec.gov/dera/staff-papers/white-papers/dera-white-paper-regulation-d-082018>.
4. Rules 5122 and 5123 provide exemptions from the filing requirement when certain types of securities are sold or securities are sold to certain types of investors. For example, member firms are not required to file offerings made pursuant to Securities Act Rule 144A or Regulation S, or offerings sold solely to institutional accounts as defined in FINRA Rule 4512(c). See Rules 5122(c) and 5123(b). As a result of these exemptions, both rules apply predominately to retail private placements.
5. The total for “new offering filings” excludes duplicate filings for the same offering by different member firms.
6. “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.
7. See FINRA’s [2019 Annual Risk Monitoring and Examinations Priorities Letter](#) (January 2019). The letter discusses factors FINRA may consider in reviewing online distribution platforms.
8. See [Regulatory Notice 19-31](#) (September 19, 2019), Question 3 (“FINRA rules require that communications be fair and balanced, but don’t require them to be exhaustive lists of all possible risks and warnings associated with a product or service. Information about risks, costs or drawbacks is more effective when it is related to the benefits that the communication promotes.”).
9. For example, pursuant to Rule 2210(b)(1)(C), if a member firm has already filed a retail communication with FINRA’s Advertising Regulation Department and received a letter indicating that such communication appears to be consistent with applicable standards, another member firm may use that communication without having a principal approve it, provided the communication is not materially altered or used in a manner that is inconsistent with the department’s letter.
10. Emphasis added. Rule 2210’s definitions of correspondence and institutional communications also refer to communications that are “distributed or made available” to particular investors. See FINRA Rules 2210(a)(2) and (a)(3).
11. See e.g., *Phillipe N. Keyes*, 89 S.E.C. 792, 800 (2006), *Sheen Financial Resources, Inc.*, Exchange Act Release No. 35477, 52 SEC 185, SEC LEXIS 613 (1995), *Fidelity Brokerage Services LLC*, Letter of Acceptance, Waiver and Consent No. 2008013056101 (2011) or *HSBC Securities (USA) Inc.*, Letter of Acceptance Waiver and Consent No 008013863801 (2010).
12. See FINRA Rule 2210(d)(1)(D).
13. Rule 2210(d)(1)(F) contains three exceptions from this prohibition, subject to specified conditions: (1) hypothetical illustrations of mathematical principles; (2) investment analysis tools and reports generated by such tools; and (3) a price target contained in a research report.
14. Gross margin represents the percent of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold by a company. See *Jay Michael Fertman*, 51 SEC 943,950 (1994) and *Excel Fin., Inc.*, 53 SEC 303, 311-12 (1997).

15. See [\*Regulatory Notice 13-18\*](#) (May 2013).
16. *Id.* “In order to be fair and balanced, firm communications concerning a real estate program may not include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods.”
17. IRR is also known as money-weighted returns. This can be contrasted to a time-weighted return, which is the compounded growth rate of \$1 over the time period. Average annual total returns used by mutual funds pursuant to SEC Rule 482 are an example of time-weighted returns. Time-weighted returns ignore the size and timing of investment cash flows and therefore provide a measure of manager or strategy performance, while IRR measures how a specific portfolio performed in absolute terms.
18. The CFA Institute is a global association of investment professionals. See generally [\*CFA Institute Global Investment Performance Standards\*](#).

# Regulatory Notice

## 21-10

## Private Placement Filer Form

### FINRA Updates Private Placement Filer Form Pursuant to FINRA Rules 5122 and 5123

Effective Date: May 22, 2021

#### Summary

FINRA has updated the form that members must use to file offering documents and information pursuant to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) (Filer Form). The updated Filer Form will be accessible in the FINRA Gateway beginning May 22, 2021, and includes new and updated questions that will facilitate review of the filed material.<sup>1</sup> Beginning on May 22, 2021, members will be required to complete the updated Filer Form for all new filings, as well as for new amendments to filings.

See [Attachment A](#) for a copy of the updated Filer Form. In addition, this *Notice* informs members about the information that may be requested during a FINRA examination concerning the member's private placement business. See [Attachment B](#) for a copy of the "Unregistered Offering List" template.

Questions regarding this *Notice* may be directed to:

- ▶ Minh Le, Director, Corporate Financing, at (240) 386-4638 or [Minh.Le@finra.org](mailto:Minh.Le@finra.org);
- ▶ Janet Boysen, Manager, Corporate Financing, at (240) 386-5101 or [Janet.Boysen@finra.org](mailto:Janet.Boysen@finra.org); or
- ▶ Kathryn Moore, Associate General Counsel, Office of General Counsel, at (202) 728-8200 or [Kathryn.Moore@finra.org](mailto:Kathryn.Moore@finra.org).

#### Background and Discussion

FINRA Rule 5122 establishes disclosure and filing requirements for members that sell a private placement of an unregistered security issued by a broker-dealer or a control entity. Its companion rule, FINRA Rule 5123, requires members that sell a private placement to file a copy of any offering documents with FINRA within 15 calendar days of the first sale, subject to various exemptions.<sup>2</sup> FINRA requires members to submit the Filer Form that contains information about the member selling the private placement

March 11, 2021

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Corporate Finance
- ▶ Legal
- ▶ Operations
- ▶ Private Placement
- ▶ Registered Representatives
- ▶ Senior Management
- ▶ Underwriting

#### Key Topics

- ▶ Private Placement
- ▶ Underwriting

#### Referenced Rules & Notices

- ▶ FINRA Rule 3280
- ▶ FINRA Rule 5122
- ▶ FINRA Rule 5123
- ▶ Regulatory Notice 10-22

securities, the issuer and the offering terms as well as any offering documents, if applicable, electronically through the FINRA Gateway.<sup>3</sup> If more than one firm is selling, a firm can make the required filing on behalf of others.

The Filer Form has three main components: the “Participating Member Information” section; the “Issuer Information” section; and the “Offering Information” section.

On May 22, 2021, FINRA will begin using an updated Filer Form that adds new questions, and clarifies certain existing questions and requests for information in the Offering Information section. The updates are designed to enhance oversight in particular areas of risk in the private placement market. Collecting targeted information in these areas will enhance investor protection and efficiency. For example, the updated Filer Form addresses the most relevant information at the outset, reducing the possibility that members will need to respond to additional FINRA information requests. FINRA describes these changes below. Attachment A is a copy of the revised Filer Form.

## Contingency Offerings

FINRA is adding the following questions concerning contingency offerings:

- ▶ the date by which the contingency must be met;
- ▶ whether there have been any changes to the original terms of the contingency during the course of the offering (*e.g.*, extension of the date by which the contingency must be met); and
- ▶ whether the subscription process involves the member receiving or transmitting investor funds in the offering. If so, there will be a follow-up question to identify what entity is acting as the escrow agent or trustee for investor funds, and to provide the name of the escrow agent if applicable.

## Disciplinary History of the Issuer, its Principals and Affiliates

FINRA is adding questions to obtain clarification on the disciplinary history of the issuer, the issuer’s principals and affiliates. FINRA reminds members of their obligation to conduct a reasonable investigation of the issuer and securities they recommend.<sup>4</sup>

FINRA is amending the existing question to include actions or proceedings involving any federal agency, not just the SEC. The revised question is as follows (changes in bold):

Has the issuer, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates been the subject of FINRA, SEC **or other federal agency**, or state disciplinary actions or proceedings or criminal complaints within the last 10 years?



If the member answers yes, this section will request identifying information about the person or entity that is the subject of the action, proceeding or complaint. If such person or entity has registration records in CRD, the member may enter the CRD information for identification purposes and there are no further questions. Otherwise, the section will request the name of the individual or entity with the disciplinary history; additional information concerning the type of proceeding (*e.g.*, FINRA, federal agency, state, criminal); the approximate date of the proceeding; and the current status.

## Intended Use of Proceeds

FINRA is amending the question about the intended use of offering proceeds as follows (changes in bold):

**Does the issuer intend** to use offering proceeds to make or repay loans to, purchase assets from, or **otherwise direct investor proceeds** to any officer, director, or executive management of the issuer, sponsor, general partner, manager, advisor, or any of the Issuer's affiliates?

If the member responds yes to this question, this section will request additional information concerning the type of payment and approximate dollar amount of offering proceeds that is intended for that purpose. The responsibility of members to conduct a reasonable investigation of the offering includes review of the intended use of proceeds.<sup>5</sup>

## Private Securities Transactions

The Offering Information section also asks the member to identify whether the filing is for an offering that its associated person is selling in a private securities transaction subject to FINRA Rule 3280.

## Additional Changes

FINRA is also making changes to three existing questions in order to clarify the information requested, make relevant updates, and improve data collection.

First, FINRA asks whether the member has commenced sales (applicable to FINRA Rule 5123 filings) or offers or provided offering documents to investors (FINRA Rule 5122 filings). If yes, FINRA will request the date of first sale (or offer or provided documents).

Second, the Offering Information section removes Rule 505 from the list of exemptions from registration. Rule 505 was repealed in 2016 and is no longer an available exemption.

Finally, the Filer Form amends the process by which the member uploads offering documents that it used in connection with the sale of the offering. For each document that the member uploads, the Filer Form requests that the member identify the type of document using a check-box. The member has the option to select more than one type of document.

### Member Supervision Examinations

In keeping with the changes to the Filer Form discussed above, FINRA believes that additional transparency on examinations of members that conduct private placement business may promote efficiency. During the course of an examination of a member that engages in a private placement business, FINRA staff may request information related to that activity. These requests generally seek information not already provided by members in their FINRA Rule 5122 and 5123 filings, and in some cases may include offerings exempted from filing under FINRA Rules 5122 or 5123.

Members that conduct a private placement business can expect FINRA staff to request a list of private placements they are selling or have sold and certain data pertaining to each. The staff uses this information to assess and evaluate the risks associated with the member's private placement activities. To assist members in preparing for these requests, please see Attachment B, "Unregistered Offering List Request" template, that lists the types of information that FINRA will request from members as part of an examination.

### Endnotes

1. See Securities Exchange Act Release No. 91047 (February 3, 2021); 86 FR 8819 (February 9, 2021) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2021-002).
2. FINRA Rule 5123(a) requires broker-dealers to "provide FINRA with the required documents or notification and related information, if known, by filing an electronic form in a manner prescribed by FINRA."
3. If a member sells a private placement without using an offering document, the member must state that fact.
4. See [Regulatory Notice 10-22](#) (April 2010).
5. *Id.*

# Regulatory Notice

21-26

## Private Placement Retail Communications

### FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements

Implementation Date: October 1, 2021

#### Summary

FINRA has adopted changes to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) to require members to file retail communications that promote or recommend private placement offerings that are subject to those rules' filing requirements.<sup>1</sup> The new filing requirements become effective on October 1, 2021.

The amended text of the rules is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Paul Mathews, Vice President, Corporate Financing, at (240) 386-4639 or [paul.mathews@finra.org](mailto:paul.mathews@finra.org);
- ▶ Amy Sochard, Vice President, Advertising Regulation, at (240) 386-4508 or [amy.sochard@finra.org](mailto:amy.sochard@finra.org); or
- ▶ Joseph P. Savage, Vice President, Office of General Counsel, at (240) 386-4534 or [joe.savage@finra.org](mailto:joe.savage@finra.org).

#### Background and Discussion

##### FINRA Rules 5122 and 5123

Rule 5122 applies to private placements of unregistered securities issued by a member or a control entity<sup>2</sup> ("member private offerings"). The rule requires the member or control entity to provide prospective investors with a private placement memorandum (PPM), term sheet, or other offering document that discloses the intended use of the offering proceeds, the offering expenses and the amount of selling compensation that will be paid to the member and its associated persons.

July 15, 2021

#### Notice Type

- ▶ Rule Amendment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Senior Management

#### Key Topics

- ▶ Advertising Regulation
- ▶ Communications with the Public
- ▶ Corporate Financing
- ▶ Private Placements
- ▶ Retail Communications

#### Referenced Rules and Notices

- ▶ FINRA Rule 2210
- ▶ FINRA Rule 4512
- ▶ FINRA Rule 5122
- ▶ FINRA Rule 5123
- ▶ FINRA Rule 5130
- ▶ Regulatory Notice 09-27
- ▶ Regulatory Notice 20-21
- ▶ Securities Act Rule 144A

The rule also requires a member to file the PPM, term sheet or other offering document with the FINRA Corporate Financing Department (“Corp Fin”) at or prior to the first time the document is provided to any prospective investor.<sup>3</sup> Many member private offerings are exempt from the rule’s requirements, including among others, offerings sold only to institutional accounts, as defined in FINRA Rule 4512(c),<sup>4</sup> qualified purchasers, as defined in the Investment Company Act of 1940,<sup>5</sup> and qualified institutional buyers,<sup>6</sup> as defined in Rule 144A under the Securities Act of 1933 (“Securities Act”).<sup>7</sup>

Rule 5123 requires members to file with FINRA any PPM, term sheet or other offering document, including any material amended versions thereof, used in connection with a private placement of securities within 15 calendar days of the date of first sale. Rule 5123 exempts private placements that are filed under other FINRA Corporate Financing Rules, as well as most of the same categories of private placements that are exempt from filing under Rule 5122.<sup>8</sup> As a result of these exemptions, both rules apply predominately to private placements sold to retail investors.

Members that sell private placements may use a PPM or term sheet alone, or may use a variety of other offering documents in addition to, or instead of, a PPM or term sheet. Although, prior to these amendments, Rules 5122 and 5123 did not require retail communications governed by Rule 2210 (Communications with the Public) to be filed, many members filed these communications with their required documents.<sup>9</sup> Examples of these retail communications have included web pages, slide presentations, pitch decks, one-page “teasers,” fact sheets, sales brochures, executive summaries and investor packets.<sup>10</sup>

FINRA has amended Rules 5122 and 5123 to require firms to file with Corp Fin retail communications that promote or recommend a private placement offering subject to those rules’ filing requirements, in addition to the currently required PPMs, term sheets and other offering documents.<sup>11</sup> The amendments do not apply to any offerings that are currently exempt from filing, such as sales exclusively to institutional accounts.<sup>12</sup> The amendments will require a member to file such retail communications with Corp Fin no later than the date on which the member must file the private placement offering documents under Rules 5122 and 5123.<sup>13</sup>

FINRA expects that members will file most retail communications with Corp Fin at the same time and in the same manner that they file their PPMs, term sheets and other offering documents. The rules’ requirements that members file material amendments to offering documents also will apply to material amendments to retail communications.

The amendments to FINRA Rules 5122 and 5123 become effective on October 1, 2021.

## Endnotes

1. See Securities Exchange Act Release No. 92133 (June 9, 2021), 86 FR 31764 (June 15, 2021) (SR-FINRA-2020-038) (Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, 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).
2. A "control entity" means any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons. See FINRA Rule 5122(a)(2). Control means beneficial interest, as defined in FINRA Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity. Control is determined immediately after the closing of an offering, and in the case of an offering with multiple intended closings, immediately following each closing. See FINRA Rule 5122(a)(3).
3. Rule 5122 also requires the filing of any amendments or exhibits to such documents within 10 days of being provided to any investor or prospective investor. See FINRA Rule 5122(b)(2).
4. Rule 4512(c) defines "institutional account" as the account of:
  - (1) a bank, savings and loan association, insurance company or registered investment company;
  - (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
  - (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.
5. See 15 U.S.C. 80a-2(a)(51).
6. See 17 CFR 230.144A(a)(1).
7. See Rule 5122(c) for a complete list of exempt member private offerings.
8. See FINRA Rule 5123(b) for a complete list of exempt private placements.
9. [Regulatory Notice 09-27](#) (May 2009), which announced SEC approval of Rule 5122, stated that the rule imposes no additional requirements regarding the filing of advertisements or sales materials. However, as noted, many firms have, in fact, filed retail communications that promote or recommend private placements under Rules 5122 and 5123.
10. In [Regulatory Notice 20-21](#) (July 1, 2020), FINRA provided guidance to help member firms comply with Rule 2210 when creating, reviewing, approving, distributing, or using retail communications concerning private placement offerings.
11. Members must file the offering documents and retail communications via FINRA's Private Placement Filing System in Firm Gateway.
12. See *supra* notes 7 and 8.
13. As discussed above, Rule 5122 requires a member subject to the rule to file the PPM, term sheet or other offering document with FINRA at or no later than the first time the document is provided to a prospective investor. Any amendments or exhibits to such offering documents also must be filed with FINRA within 10 days of being provided to any investor or prospective investor. See Rule 5122(b)(2). Rule 5123 requires a member subject to the rule to submit to FINRA, or have submitted on its behalf by a designated member, the PPM, term sheet or other offering document, including any materially amended versions thereof, used in connection with the sale of securities covered by the rule within 15 calendar days of the date of first sale, or notify FINRA that no such offering documents were used. See Rule 5123(a).

## Attachment A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \* \* \*

### 5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

#### 5120. OFFERINGS OF MEMBERS' SECURITIES

\* \* \* \* \*

#### 5122. Private Placements of Securities Issued by Members

(a) No Change.

##### (b) Requirements

No member or associated person may offer or sell any security in a Member Private Offering unless the following conditions have been met:

(1) No Change.

##### (2) Filing Requirements

A member must file the private placement memorandum, term sheet, or [such] other offering document, and any retail communication (as defined under Rule 2210) that promotes or recommends the member private offering with the Corporate Financing Department at or prior to the first time the document or retail communication is provided to any prospective investor. Any amendment(s) or exhibit(s) to the private placement memorandum, term sheet, [or] other offering document or retail communication also must be filed with the Department within ten days of being provided to any investor or prospective investor.

(3) No Change.

(c) through (e) No Change.

#### • • • Supplementary Material: -----

No Change.

**5123. Private Placements of Securities****(a) Filing Requirements**

Each member that sells a security in a non-public offering in reliance on an available exemption from registration under the Securities Act (“private placement”) must: (i) submit to FINRA, or have submitted on its behalf by a designated member, a copy of any private placement memorandum, term sheet or other offering document, and any retail communication (as defined in Rule 2210) that promotes or recommends the private placement, including any materially amended versions thereof, used in connection with such sale within 15 calendar days of the date of first sale; or (ii) notify FINRA that no such offering documents or retail communications were used. Members must provide FINRA with the required documents, retail communications, or notification and related information, if known, by filing an electronic form in the manner prescribed by FINRA.

(b) through (d) No Change.

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