

Regulatory Notice

13-26

Private Placements of Securities

FINRA Updates Form for Filing Private Placements of Securities Pursuant to FINRA Rules 5122 and 5123

Executive Summary

FINRA has updated the form that firms must use to file offering documents and information pursuant to FINRA Rules 5123 (Private Placements of Securities) and 5122 (Private Placements of Securities Issued by Members). The updated form, which is available in the FINRA Firm Gateway, includes six new questions, which are further described in this *Notice*.¹ FINRA also has updated the [Private Placement Form Frequently Asked Questions](#) (FAQ).

Questions concerning this *Notice* should be directed to:

- ▶ Joseph E. Price, Senior Vice President, Corporate Financing Department, at (240) 386-4642; or
- ▶ Lisa Jones Toms, Senior Director and Counsel, Corporate Financing Department, at (240) 386-4623.

Background & Discussion

Effective December 3, 2012, firms are required to submit filings pursuant to FINRA Rules 5122 and 5123 through the Firm Gateway.² Rule 5122 establishes standards on disclosure and use of proceeds and requires firms to file private placements offered or sold by a member firm or an associated person. Rule 5123 requires each firm that sells a security in a private placement (with certain exemptions) to file a copy of the offering document with FINRA within 15 calendar days of the date of the first sale.³ If a firm sells a private placement without using an offering document, then the firm must state that fact. Rules 5122 and 5123 require firms to file any materially amended versions of the documents originally filed.

August 2013

Notice Type

- ▶ Guidance

Suggested Routing

- ▶ Compliance
- ▶ Corporate Finance
- ▶ Legal
- ▶ Operations

Key Topics

- ▶ Private Placement Memorandum
- ▶ Private Placements
- ▶ Regulation D

Referenced Rules & Notices

- ▶ FINRA Rule 5122
- ▶ FINRA Rule 5123
- ▶ Regulatory Notice 10-22
- ▶ SEA Rule 10b-9
- ▶ SEA Rule 15c2-4
- ▶ SEC Regulation D
- ▶ SEC Rule 506
- ▶ Securities Act Rule 144A



Financial Industry Regulatory Authority

In [*Regulatory Notice 10-22*](#), FINRA provided guidance on the scope of a firm's responsibility to conduct a reasonable investigation of the private placement issuer. As described in that *Notice*, the amount and nature of the investigation required depends, among other factors, upon the nature of the recommendation, the role of the firm in the transaction, its knowledge of and relationship to the issuer, and the size and stability of the issuer. Each firm must make a determination of the scope of its investigation based upon the facts and circumstances. In general, however, a firm may not rely upon the information provided by the issuer or its counsel in lieu of conducting its own reasonable investigation.⁴

Private Placement Form

On July 1, 2013, FINRA began using an updated Private Placement Form that includes six new questions that the firm making the filing must answer based on information contained in the offering document or if otherwise known by the firm completing the form. Firms participating in private placements often have information beyond what is disclosed in offering documents as a result of their suitability investigations or other reviews. However, to the extent a firm does not otherwise have knowledge that is responsive to a question, the form does not require firms to seek out the answers to the question. Rather, the filing broker-dealer can answer "yes," "no" or "unknown."⁵ When a firm has obtained information in its investigation of the private placement issuer such that the answers to the questions are known to the firm making the filing, they must be completed with a "yes" or "no" answer.⁶

FINRA has added the following six questions to the form:

- ▶ Is this a contingency offering?
- ▶ Does the issuer have any independently audited financial statements for the issuer's most recent fiscal year?
- ▶ Is the issuer able to use offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer's affiliates?
- ▶ Does the issuer have a board of directors comprised of a majority of independent directors or a general partner that is unaffiliated with the firm?
- ▶ Has the issuer engaged, or does the member anticipate that the issuer will engage, in a general solicitation in connection with the offering or sale of the securities?
- ▶ 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 SEC, FINRA, or state disciplinary actions or proceedings or criminal complaints within the last 10 years?

The form also asks firms to select an industry category for the specified private placement. See Attachment A for a copy of the form.

Review Priorities

The form assists FINRA in prioritizing its review of private placement filings. The questions are not intended to set new standards of disclosure, due diligence or information gathering requirements for firms involved in the private placement offerings. Examples of information that can affect our review prioritization include the following:

- ▶ The private placement is a contingency offering in which no escrow agent is used, or an escrow agent that is used does not comply with Rule 15c2-4 under the Securities Exchange Act of 1934 (SEA). Many private placements are conducted as best efforts contingency offerings that must comply with various SEC rules, including SEA Rules 10b-9 and 15c2-4. SEA Rule 15c2-4 requires any broker-dealer that participates in a best efforts contingency offering to appoint a bank as escrow agent or deposit funds in a segregated bank account.
- ▶ An auditor has questioned whether the issuer can continue as a going concern.
- ▶ The offering is for interests in a pooled investment fund, the terms of which do not limit the use of offering proceeds to make or repay loans to, or purchase assets from, any insiders of the fund. Approximately 25 percent of SEC Rule 506 issuers are pooled investment funds.⁷
- ▶ The issuer, any officer, director or executive management, sponsor, general partner, manager, advisor or its affiliate has a relevant disciplinary history. This is true whether or not the relevant disciplinary history would disqualify the issuer from engaging in an SEC Regulation D offering.⁸
- ▶ In addition, some information may raise questions about the quality of the suitability analysis that the firm may have conducted.
- ▶ To assist firms, FINRA is providing additional guidance in the [Private Placement Form FAQ](#).⁹ See Attachment B for a copy of the FAQ.

Endnotes

1. See Securities Exchange Act Release No. 69843 (June 25, 2013); 78 FR 39367 (July 1, 2013) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2013-026).
2. FINRA Firm Gateway is an online compliance tool that provides consolidated access to FINRA applications and allows firms to submit required filings electronically to meet their compliance and regulatory obligations.
3. This 15-day time period corresponds with the filing requirement for issuers under SEC Form D. See SEC Form D (Notice of Exempt Offering of Securities) General Instructions (“An issuer must file a new notice with the SEC for each new offering of securities no later than 15 calendar days after the ‘date of first sale’ of securities in the offering...”).
4. See, e.g., *District Business Conduct Committee for District No. 4 v. Everest Securities, Inc.*, 1994 NASD Discip. LEXIS 188 (Sept. 2, 1994), *aff’d*, 52 S.E.C. 958, 962-63 (Aug. 26, 1996), *aff’d*, 116 F.3d 1235, 1239 (8th Cir. 1997) (“reliance on others does not excuse [the respondents’] own lack of investigation”).
5. Since filers began using the new form on July 1, 2013, on average, 18 percent of filers have answered “unknown” to at least one of the six questions. Approximately 28 percent of filers have answered “unknown” to the question regarding whether the issuer, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates has been the subject of SEC, FINRA, or state disciplinary actions or proceedings or criminal complaints within the last 10 years. Approximately 8 percent have answered “unknown” to the question regarding whether the issuer has independently audited financial statements available for the issuer’s most recent fiscal year.
6. Rule 5123 requires firms to “provide FINRA with the required documents or notification and related information, if known, by filing an electronic form in the manner prescribed by FINRA.” Filing information a firm knows is inaccurate would violate that requirement.
7. See Vladimir Ivanov and Scott Bauguess, [Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009 - 2012](#) (July 2013), at 14, 19-20.
8. See Securities Act Release No. 9414 (July 10, 2013), 78 FR 44730 (July 24, 2013) (Disqualification of Felons and Other “Bad Actors” from Rule 506 offerings).
9. Concurrently with this *Notice*, FINRA is publishing a revised version of the Sale of Private Placements Frequently Asked Questions, which includes a section on the new filing questions, to provide members with further clarification on the purpose and scope of these questions. The Sale of Private Placements Frequently Asked Questions can be found on FINRA’s website at www.finra.org/Industry/Compliance/RegulatoryFilings/PrivatePlacements/.

5122 / 5123 Notification Filing

All fields marked with an * are mandatory.

Identify Rule

* Filing Under: ☐ Rule 5122 ☐ Rule 5123

Participating Member Information

* Firm Name: CRD:

* Contact Name: * Contact Title:

* Email: Phone:

* Relationship to Issuer or Sponsor: ☐ Affiliate ☐ Non-Affiliate

Identify any other members participating in the offering upon whose behalf you are submitting an offering document:

List of Participating Members

Firm Name ▲	Firm CRD	Contact Name	Title	Phone
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Add New

0 Row(s)

Issuer Information

* Issuer Name:

* Contact Name: * Title:

* Street: * City: State:

Postal Code: * Country:

Email: * Phone:

* Please provide the issuer CIK Number (when applicable): ☐ No CIK

Based on the information contained in the offering document (or if otherwise known by your firm), please select an industry category for the offered securities:

* Select the industry:

Offering Information

- * Maximum Amount to be Raised (in \$): ☐ Unknown
- * Anticipated Offering Period:
- * Commencement Date: ☐ Unknown
- * Conclusion Date: ☐ Unknown ☐ Continuous
- * Maximum Sales Commission (% rate): ☐ Unknown
- * Aggregate amount of any other compensation to registered persons disclosed in the offering document: ☐ \$ Amount ☐ % Rate ☐ Unknown
- * Stated or Target Rate of Return as disclosed in the offering document (%): ☐ Unknown ☐ Not Applicable
- * Is the Form D filing information available? ☐ Yes ☐ No
- * Did your firm use a private placement memorandum in connection with any sales in the offering? ☐ Yes ☐ No

Based on the information contained in the offering document (or if otherwise known by your firm):

- * Is this a contingency offering? ☐ Yes ☐ No ☐ Unknown
- * Does the issuer have any independently audited financial statements for the most recent fiscal year? ☐ Yes ☐ No ☐ Unknown
- * Is the issuer able to use offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer's affiliates? ☐ Yes ☐ No ☐ Unknown
- * Does the issuer have a board of directors comprised of a majority of independent directors or a general partner that is unaffiliated with the firm? ☐ Yes ☐ No ☐ Unknown
- * Has the issuer engaged, or do you anticipate that the issuer will engage, in a general solicitation in connection with the offering or sale of the securities? ☐ Yes ☐ No ☐ Unknown
- * 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 SEC, FINRA, or state disciplinary actions or proceedings or criminal complaints within the last 10 years? ☐ Yes ☐ No ☐ Unknown

Please enter any additional information you would like to provide to facilitate FINRA's review:

You have 3500 character(s) left.

Attachment B

Private Placement Form Frequently Asked Questions (FAQ)

Beginning July 1, 2013, FINRA implemented an updated private placement form that includes six new questions, which require the firm making the filing to answer “yes,” “no” or “unknown” based on information contained in the offering document or otherwise known by the firm making the filing. FINRA is providing the following FAQ regarding the form and updated questions.

1. The form asks whether the offering being filed is a contingency offering. What is a “contingency offering?”

For purposes of the form, a contingency offering is a private placement in which the actual closing or sale of securities in the private placement is contingent on an event, typically the receipt of orders for a minimum aggregate amount of securities by an expiration date. Filers participating in contingency offerings must familiarize themselves with, and follow, the relevant SEC rules, including Rules 15c2-4 and 10b-9 under the Securities Exchange Act of 1934.

2. When a firm completes the form and files offering documents on behalf of itself and other firms that are participating in the same offering, must the answers to the form’s questions be based on the knowledge of all the firms or only the firm filing the form?

The form provides that the firm submitting the filing must answer the questions “[b]ased on the information contained in the offering document (or if otherwise known by your firm).” The firm submitting the form must review the offering document in order to answer the questions. Firms participating in a private placement are required to conduct a reasonable investigation of the private placement issuer. The requirement to answer the form’s questions imposes no new requirement on the filing firm to obtain information, beyond those responsibilities discussed in *Regulatory Notice 10-22*. Information about the issuer or the offering may have been obtained by the filing firm from several sources. If information that can be used to answer the questions is known by the filing firm, it should be used to answer the questions regardless of whether it originated with another participating firm or any other entity.

3. Is the firm making the filing required to obtain sufficient information so that it can answer “yes” or “no” to the questions instead of “unknown?”

The form itself does not require firms to obtain information sufficient to answer questions yes or no. The scope of a firm’s obligations to conduct a reasonable due diligence investigation of a private placement issuer is addressed in [*Regulatory Notice 10-22*](#). Neither FINRA Rule 5123 nor the form imposes any additional requirement of investigation beyond what is discussed in that *Notice*.

4. **The form asks whether the issuer is “able to use offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates.” If the offering documents do not address such use, but the issuer makes representations to the firm that such use of proceeds is impermissible, should the firm answer “no?”**

Firms participating in private placements often obtain information beyond what is disclosed in offering documents as a result of their own reviews and reasonable investigations. If the firm has information, including representations from the issuer, from which it concludes there are limits in place against such use of proceeds, the firm should answer “no.”

5. **Why is the form’s question regarding the issuer’s disciplinary history different than the SEC’s Rule 506 disqualification (“Bad Actor”) provision?**

The SEC recently adopted amendments to Regulation D under the Securities Act of 1933 that require specific disclosure or make the exemption under Rule 506 unavailable if a “Covered Person” is subject to a “Disqualifying Event.” The amendments provide nine types of Covered Persons and 18 separate Disqualifying Events. Disqualifying Events that occur before September 23, 2013, the effective date of the SEC’s “Bad Actor” provision, must be disclosed to investors, and Disqualifying Events that occur on or after the effective date result in the offering being ineligible to rely on SEC Rule 506.

The form asks whether the issuer, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer’s affiliates has been the subject of SEC, FINRA or state disciplinary actions or proceedings or criminal complaints within the last 10 years. The criteria of Covered Persons or Disqualifying Events that the SEC adopted in its Bad Actor provision are not relevant to the disciplinary history question on the form, which is used to assist FINRA in prioritizing the reviews of private placements, not to screen offerings for compliance with SEC requirements.

6. What are “independently audited financial statements” for purposes of the form?

Independently audited financial statements are financial statements prepared in accordance with generally accepted accounting principles, or GAAP, and audited by an independent certified public accountant in accordance with generally accepted auditing standards.

7. Can a firm explain why a question in the form was answered in a particular way, or provide additional information not requested in the form?

FINRA encourages firms to provide explanations or additional information, as appropriate, in the text box at the end of the form.

8. Do the SEC’s recent amendments that permit general solicitation for certain offerings under Rule 506 of Regulation D eliminate the filing requirements of Rule 5122 or 5123 for these offerings?

No. Whether general solicitation is used to market a private placement is irrelevant to whether the offering must be filed pursuant to FINRA Rule 5122 or 5123.

9. How will FINRA use the answer to the question about whether a Form D has been filed?

The answer to the question assists FINRA in deciding whether to access the EDGAR database to review Form Ds.