

PUBLICATION

FINRA Amends Proposed Rule 5123 on Private Placements

March 15, 2012

On January 20, 2012, the Financial Industry Regulatory Authority (FINRA) filed with the Securities and Exchange Commission (SEC) a Partial Amendment No. 1 to proposed FINRA Rule 5123 (Private Placement of Securities) to address concerns found in comments to the proposed rule. The amendment narrows the proposed definition of "private placement" and modifies the disclosure and filing requirements of the Rule. The amended rule is now under consideration by the SEC.

Background

In October 2011, FINRA proposed to adopt a new rule, FINRA Rule 5123 (Private Placements of Securities,) which would require members selling a private placement to make certain disclosures to potential investors and file such disclosures with FINRA. FINRA proposed the rule in light of what it considers widespread fraud in connection with private placements.

The proposed Rule 5123 would require members and associated persons who offer or sell applicable private placements, or participate in the preparation of private placement memoranda (PPM), term sheets or other disclosure documents in connection with private placements, to provide disclosures to investors prior to sale describing the use of proceeds and the amount and type of offering expenses and offering compensation. Rule 5123 would also require members to file the PPM, term sheet or other disclosure document, including any exhibits, with FINRA within 15 days after the date of the first sale.

The proposed rule excludes sales to several types of purchasers, including institutional accounts as defined in NASD Rule 3110(c)(4), qualified institutional buyers under Rule 144A, investment companies, banks, and employees and affiliates of the issuer. The rule also excludes several types of transactions, including offerings of exempted securities, 144A and Regulation S offerings and offerings of non-convertible debt or preferred securities by issuers eligible to use Form S-3.

Comments and Resulting Amendment

FINRA received 15 comments in response to the proposed Rule 5123. On January 20, 2012, FINRA filed a partial amendment to Rule 5123 to address the concerns found in the comment letters. The amendment does the following:

- Clarifies that the rule applies to "non-public" offerings, thus exempting public offerings that are exempt from SEC registration, such as secondary sales and offerings by banks.
- Amends the disclosure requirement to apply only to sales in which a PPM, term sheet or other disclosure document drafted by or on behalf of the issuer is used.
- Revises the filing requirements of the rule so that only one member participating in the offering is required to file the disclosure document, rather than every member. If no disclosure document is used, at least one participating member must file a notice of offering with FINRA identifying the private placement and the participants and stating that no disclosure document was used.

- Adds several exemptions, including offerings sold to institutional accredited investors, "knowledgeable employees" of a private fund, offerings of registered investment companies and business combination transactions.
- Clarifies that members would not be required to deliver multiple copies of disclosure documents to a single customer.

Acknowledging that Rule 5123 would present a major change to private placements, the SEC has determined to review the rule rather than allow it to automatically take effect. The SEC has asked for general comments on the rule, but has specifically sought comments on the following issues:

- Whether members would continue to participate in private placements subject to Rule 5123;
- Whether Rule 5123 would encourage issuers to use unregistered firms to conduct their private placements; and
- Whether Rule 5123 would affect access to capital, the costs of capital raising or the costs of capital for issuers.

The SEC is obviously concerned about the rule's possible effects on capital formation through the use of private placements. As previously mentioned, Rule 5123 would have a major effect on many private placements, including almost all private placements directed at retail customers. For this reason, the SEC has questioned whether the rule is consistent with the requirements that FINRA rules "prevent fraudulent and manipulative acts, promote just and equitable principles of trade, and protect investors and the public interest."

If you have questions about the proposed amendments or any element of the Priorities Letter, please contact your Baker Donelson attorney or a member of our Broker-Dealer/Registered Investment Adviser Industry Service Team.