



## FINRA Files Amendments to FINRA Rule 5123 on Private Placements

On January 19, 2012, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed a Partial Amendment No. 1 (the “Partial Amendment”) to proposed FINRA Rule 5123 (Private Placement of Securities) with the Securities and Exchange Commission (the “SEC”)<sup>1</sup> to address concerns raised by market participants. The Partial Amendment would narrow the proposed definition of “private placement” and modify the proposed disclosure and filing requirements in private placements.

### Background

FINRA proposed Rule 5123 (the “Proposed Rule”) on October 5, 2011.<sup>2</sup> Comments were due on November 18, 2011. The SEC received 16 comment letters in response to the Proposed Rule. On November 17, 2011, FINRA extended the period for the SEC to approve the Proposed Rule to January 20, 2012. The comments expressed a broad range of concerns, including concerns regarding: the scope of the definition of private placement; the broker-dealer disclosure requirements; the filing requirements; the exemptions; and whether the Proposed Rule is consistent with FINRA’s regulatory oversight and authority. FINRA responded to the comments in its Response Letter and filed the Partial Amendment to address these concerns.<sup>3</sup>

### The Partial Amendment

The Partial Amendment:

- Clarifies that the term “private placement” in the Proposed Rule would mean a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act of 1933, as amended (the “Securities Act”), making it consistent with FINRA Rule 5122. The definition would not apply to securities offered pursuant to:
  - Sections 4(1), 4(3) and 4(4) of the Securities Act;

<sup>1</sup> See Notice of Filing of Partial Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as modified by Partial Amendment No. 1, to Adopt FINRA Rule 5123 (Private Placements of Securities), Exchange Act Release No. 66203 (the “SEC Release”) (Jan. 20, 2012), available at <http://www.sec.gov/rules/sro/finra/2012/34-66203.pdf>.

<sup>2</sup> For a discussion of the evolution and contents of the Proposed Rule, see our client alert available at <http://www.mofo.com/files/Uploads/Images/111010-FINRA-Proposes-Rule-5123-in-lieu-of-Proposed-Rule-5122.pdf>.

<sup>3</sup> The text of Partial Amendment No. 1 and FINRA’s Response Letter are available at <http://www.finra.org/Industry/Regulation/RuleFilings/2011/P124600>.

- Sections 3(a)(2) (offerings by banks), 3(a)(9) (exchange transactions), 3(a)(10) (securities subject to a fairness hearing), or 3(a)(12) (securities issued by a bank or bank holding company pursuant to reorganization or similar transactions), of the Securities Act; or
- Section 1145 of the Bankruptcy Code (securities issued in a court-approved reorganization plan that are not otherwise entitled to the exemption from registration afforded by Securities Act Section 3(a)(10)).
- Amends the filing and disclosure requirements for those private placements for which a disclosure document includes a description of the anticipated use of offering proceeds, the amount and type of offering expenses and compensation provided or to be provided to sponsors, finders, consultants, and members and their associated persons in connection with the offering. Members would be required to provide, prior to any sale, the disclosure document to each investor other than those investors in a private placement that would be subject to an exemption, as provided by the Proposed Rule, as amended.<sup>4</sup> Each member participating in the offering, or a member designated to make the filing on behalf of all members identified in the filing, would also be required to file such document with FINRA no later than 15 calendar days after the date of first sale.
- Amends the filing and disclosure requirements for those private placements for which there is no disclosure document to eliminate the requirement that members provide investors with the required disclosures. If no disclosure document is used, the participating member (or a designated member acting on behalf of the member) would instead be required to make a notice filing, identifying the private placement and the participating members and stating that no disclosure document was used, with FINRA no later than 15 calendar days after the date of first sale. The Proposed Rule as amended by the Partial Amendment would not prohibit a member from participating in such private placements, and would not require the member to make any additional disclosure to investors in such offerings.
- Clarifies that the Proposed Rule would not require delivery of multiple copies of a disclosure document to a single customer. Specifically, the Proposed Rule would require an affected member to deliver disclosure documents only to persons to whom it sells shares in the private placement.

## What's Next?

In light of the issues raised by the Proposed Rule, the SEC determined to institute proceedings pursuant to Section 19(b)(2) of the Securities and Exchange Act of 1934, as amended (the "Exchange Act") to determine whether to approve FINRA's Proposed Rule. In its release, the SEC stated, "Institution of such proceedings appears appropriate at this time in view of the legal and policy issues raised by the proposed rule change."<sup>5</sup> The SEC also stated it believes FINRA's Proposed Rule, as amended by the Partial Amendment, raises questions as to whether it is consistent with the requirements of Section 15A(b)(6) of the Exchange Act. Section 15A(b)(6) requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

It remains uncertain whether the Proposed Rule, as amended by the Partial Amendment, would be approved by the SEC. Comments on the Proposed Rule, as modified by the Partial Amendment, are due 30 days from publication in the Federal Register. In addition to general comments, the SEC specifically seeks comments on the proposed definition of "private placement"; the potential impact on investors purchasing private placement securities through a broker-dealer; the potential impact on members of having to comply with the Proposed Rule; and the potential impact on competition and capital formation, including:

<sup>4</sup> For a description of the exemptions, see our client alert available at <http://www.mofo.com/files/Uploads/Images/111010-FINRA-Proposes-Rule-5123-in-lieu-of-Proposed-Rule-5122.pdf>.

<sup>5</sup> See SEC Release, available at <http://www.sec.gov/rules/sro/finra/2012/34-66203.pdf>.

- whether members would continue to participate in private placements subject to the Proposed Rule;
- whether the Proposed Rule would encourage issuers to use unregistered firms to effect their covered offerings; and
- whether the Proposed Rule would affect access to capital, the costs of capital raising or the cost of capital for issuers.

The future evolution of FINRA Rule 5123 will have to await another comment period.

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