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## Private Placement Update: SEC Approves FINRA Private Placement Rule

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**On June 7, 2012, the US Securities and Exchange Commission (“SEC”) approved FINRA Rule 5123 governing regulation of broker-dealer participation in private placements of securities. The new rule will require member firms to file certain disclosure documents and material amendments to previous disclosure documents with the Financial Industry Regulatory Authority, Inc. (“FINRA”).**

### Introduction

On June 7, 2012, the SEC approved FINRA's proposed Rule 5123 (the "Rule"), which, as adopted, significantly expands the scope of FINRA's regulation over broker-dealer participation in private placements.<sup>1</sup> Among other things, unless exempt, Rule 5123 imposes a notice filing requirement on member firms participating in a private placement—with FINRA no later than 15 days after the date of first sale. The Rule's various exemptions effectively limit its applicability to non-institutional private placements.<sup>2</sup>

It should be noted that FINRA has withdrawn an earlier proposal that would have required specific disclosure to each investor to whom the security is sold; that disclosure would have required (a) a description of the anticipated use of offering proceeds, (b) the amount and type of offering expenses, and (c) the amount and type of compensation provided or to be provided to sponsors, finders, consultants, and members and their associated persons in connection with the offering. As a result, the Rule as adopted requires only the filing with FINRA of the disclosure documents described below.

<sup>1</sup> See "Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendments No. 2 and No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendments No. 1, No. 2, and No. 3 to Adopt FINRA Rule 5123 (Private Placements of Securities) in the Consolidated FINRA Rulebook", SEC Release No. 34-67157 (June 7, 2012), 77 Fed. Regulation. 114 p. 35457 (the "Adopting Release").

<sup>2</sup> For more information regarding Rule 5123, you may wish to refer to < <http://www.shearman.com/FINRA-Seeks-to-Expand-Regulation-of-Private-Placements-10-31-2011/>>; < <http://www.shearman.com/finra-amends-proposed-private-placements-rule-sec-takes-rare-step-of-instituting-proceedings-to-determine-whether-to-approve-or-disapprove-04-2012/>>.

## Content of Notice Filing

Specifically, the Rule requires each member that sells a security in a Covered Offering to: (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 used in connection with such sale within 15 calendar days of the date of first sale, as well as any material amendments to a previously filed document within 15 calendar days of the date such document is provided to any investor; or (ii) indicate to FINRA that no such offering documents were used. While FINRA has indicated that the filing requirement is principally meant to allow the collection of conducted data in respect of Covered Offerings, nothing in the Rule prohibits FINRA from inquiring further in respect of any Covered Offering.

A Covered Offering is a non-public offering in reliance on an available exemption from registration under the Securities Act Of 1933 (the "Securities Act"). FINRA clarifies that this formulation of a Covered Offering would exclude from the Rule's scope, offerings of securities pursuant to the following provisions:

- Securities Act Sections 4(1), 4(3), and 4(4) (which generally exempt secondary transactions); or
- Securities Act Sections 3(a)(2) (offerings by banks), 3(a)(9) (exchange transactions with an existing holder, where no person is paid to solicit the exchange), 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); 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)).<sup>3</sup>

## Filing Requirement

As adopted, Rule 5123(a)(3) requires that the applicable disclosure document must be filed with FINRA by each participating member (or by a member designated to make such filing on behalf of members identified in the filing) no later than 15 calendar days after the date of first sale. Any material amendments to the previously filed disclosure document must be filed with FINRA no later than 15 calendar days after the date such document is provided to any investor. In response to comments, the Rule expressly permits FINRA members to designate a single FINRA member to file the disclosure document with FINRA.

## Exemptions

The Rule also provides various valuable exemptions to its applicability, including exemptions for offerings sold exclusively to institutional and sophisticated investors. These exemptions are based on either the type of purchaser or the type of offering. Several commentators requested exemptions from coverage under Rule 5123, in particular, an exemption for all accredited investors. FINRA however has refused to allow additional exemptions at this time, but has pointed to Rule 5123(d), that provides discretion to FINRA to allow for additional exemptions. Specifically, pursuant to proposed paragraph 5123(d),

<sup>3</sup> FINRA letter to Elizabeth M. Murphy, US Securities and Exchange Commission (Jan. 19, 2012), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p125461.pdf>.

FINRA would have authority to exempt a member or associated person from the provisions of the proposed Rule upon a showing of good cause.

### Exempt Purchasers

The Rule exempts offerings sold to any one or more of the following types of purchasers:

- institutional accounts, as defined in FINRA Rule 4512(c);
- qualified purchasers, as defined in section 2(a)(51)(A) of the Investment Company Act;
- qualified institutional buyers, as defined in Rule 144A of the Securities Act;
- an entity composed exclusively of qualified institutional buyers, as defined in Rule 144A of the Securities Act;
- investment companies, as defined in section 3 of the Investment Company Act;
- banks, as defined in section 3(a)(2) of the Securities Act; and
- employees and affiliates of the issuer.

### Exempt Offerings

Rule 5123 also exempts the following types of offerings:

- offerings of exempted securities, as defined in section 3(a)(12) of the Securities Exchange Act of 1934, as amended (the "Exchange Act");
- offerings made pursuant to Rule 144A of the Securities Act or SEC Regulation S;
- offerings of exempt securities with short-term maturities under section 3(a)(3) of the Securities Act;
- offerings of subordinated loans under Exchange Act Rule 15c3-1, Appendix D;
- offerings of "variable contracts," as defined in FINRA Rule 2320(b)(2);
- offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in FINRA Rule 5110(b)(8)(E);
- offerings of non-convertible debt or preferred securities by issuers that meet the eligibility criteria for incorporation by reference in Forms S-3 and F-3;
- offerings of securities issued in conversions, stock splits, and restructuring transactions that are executed by an already existing investor without the need for additional consideration or investments on the part of the investor;
- offerings of securities of a commodity pool operated by a commodity pool operator, as defined under section 1a(11) of the Commodity Exchange Act; and
- offerings filed with FINRA under any of FINRA Rules 2310, 5110, 5121, and 5122.

## Confidential Treatment

The approved rule does not change the provisions in the Proposed Rule that provides that FINRA shall accord confidential treatment to all documents and information filed pursuant to the rule, and shall utilize such documents and information solely for the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

## Impact of the JOBS Act

Among the principal concerns of commentators concerned the possible dampening effect Rule 5123 would have on the effects of the Jumpstart Our Business Startups Act of 2012 ("JOBS Act"). In particular, commentators suggested that the rule change is inconsistent with the intent of the JOBS Act to reduce regulation applicable to small business capital formation. FINRA's response to their comments is that the filing requirement does not unnecessarily burden members or capital formation in light of the intended regulatory benefits to investors of the resulting enhanced oversight.

## Conclusion

The approved FINRA Rule 5123 on Private Placements contains two principal elements that firms must now incorporate into their policies and procedures: (1) the filing requirements to FINRA and (2) the exemptions from these requirements.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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