

NEW FINRA RULE 5123—NOTICE FILING OBLIGATIONS FOR PRIVATE PLACEMENTS

BY THE SECURITIES & CAPITAL MARKETS PRACTICE GROUP

On June 7, 2012, the SEC approved on an accelerated basis proposed FINRA Rule 5123.¹ Rule 5123 will require FINRA member firms that participate in certain private placements of securities to make notice filings (which must include a copy of the offering document used in the private placement, if any) with FINRA, subject to certain exceptions, the effect of which is to require compliance for mainly retail investor marketed offerings.

Overview of FINRA Rule 5123

Rule 5123 requires that, subject to certain exceptions discussed below, a FINRA member firm that sells a security of any issuer other than the member or its affiliates² in a private placement³ must:

- 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, including any materially amended versions thereof used in connection with such sale, within 15 calendar days of the date of first sale; or
- indicate to FINRA that no such offering documents were used.

Scope of Rule

The Rule 5123 filing requirement applies only to FINRA members selling securities in private offerings. It does not require any filing in connection with securities offered pursuant to:

- Sections 4(1), 4(3), and 4(4) of the Securities Act of 1933 (which generally exempt secondary transactions);
- 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 of 1933; and
- 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)).

Filing Requirement

The Rule 5123 filing process is as follows:

- The filing of the offering documents can be made either by each member participating in the offering or by one member designated to make the filing on behalf of all members identified in the filing.
- The offering documents must be filed with FINRA no later than 15 calendar days after the date of first sale.
- The filing requirement refers to the first sale by the member making the filing (or on whose behalf a designated member is filing), rather than the first sale by another member.
- In the event of any material amendment to the offering documents during the course of the offering, the amendment also would have to be filed within 15 days of first use with an investor or potential investor.
- In the event that no offering document is used, each participating member (or a designated member) will be required to file a notice of the offering with FINRA that identifies the private placement and the participating members and states that no disclosure document was used.

FINRA has stated that the Rule is designed to provide FINRA better information about the private placement activities of member firms and assist FINRA in identifying “problematic terms and conditions” in private placements, thereby helping to detect and prevent fraud. There will be no review or approval process by FINRA for private placements. The Rule does not require a FINRA member to use disclosure documents or to make any additional disclosure to investors in such offerings.

All documents filed pursuant to FINRA Rule 5123 will be provided confidential treatment.

Exemptions

The Rule provides a number of exemptions based on the type of investors and the type of offerings. It does not apply to private placements sold exclusively to institutional accounts, qualified purchasers, certain institutional accredited investors, qualified institutional buyers, and entities composed solely of qualified institutional buyers, investment companies, and banks. It also does not apply to offerings of exempted securities under Section 3(a)(12) of the Securities Exchange Act, Rule 144A offerings, Regulation S offerings, offerings to employees and affiliates of the issuer and offerings filed with FINRA under other FINRA rules.⁴ FINRA members may rely on more than one exemption to avoid triggering the requirements of Rule 5123. There is no exemption from the filing requirements for offerings solely to accredited investors.

Practical Implications

Presently the only private placements filed with FINRA are those in which a FINRA member or its affiliate is the issuer. Although investment vehicles that rely on the exemption from registration under Section 3(c)(7) of the Investment Company Act of 1940 and are only sold to “qualified purchasers” are exempt from Rule 5123, there is no similar exemption for investment vehicle rely on the Section 3(c)(1) exemption. Accordingly, under Rule 5123, almost all private placements intended for retail

investors would require the filing of the relevant offering document if the placement agent is a broker-dealer and member of FINRA



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¹ The final rule is a narrower version of the reforms initially proposed by FINRA on October 5, 2011. The original proposal would have required FINRA members participating in certain private offerings to disclose to each investor the anticipated use of proceeds, the amount and type of offering expenses, and offering compensation. If any of the issuer's offering documents did not contain such information, the FINRA member was required to create and provide to any potential investor a separate disclosure document containing the above information. In response to a number of comment letters, the original rule underwent three amendments. The result is that only a new notice filing is required for offerings conducted without the use of offering documents.

² FINRA's existing Rule 5122, which has been in effect since March 2009, applies to private placements by a member of its own securities or securities of its affiliates.

³ A non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act of 1933, as amended.

⁴ Specifically, Rule 5122 exempts the following offerings:

- offerings of exempted securities, as defined in Section 3(a)(12) of the Exchange Act;
- offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;
- offerings of exempted securities with short term maturities under Section 3(a)(3) of the Securities Act and debt securities sold by members pursuant to Section 4(2) of the Securities Act so long as the maturity does not exceed 397 days and the securities are issued in minimum denominations of \$150,000 (or the equivalent thereof in another currency);
- offerings of subordinated loans under Exchange Act Rule 15c3-1, Appendix D;
- offerings of "variable contracts," as defined in NASD 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 that meet the transaction eligibility criteria for registering primary offerings of non-convertible securities on 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 1(a)(11) of the Commodity Exchange Act;
- offerings of business combination transactions as defined in Securities Act Rule 165(f);
- offerings of registered investment companies;
- offerings of standardized options, as defined in Securities Act Rule 238; and
- offerings filed with the Department under FINRA Rule 2310, 5110, 5121 and 5122 or exempt from filing thereunder in accordance with FINRA Rule 5110(b)(7);

Rule 5123 also exempts offerings sold by the FINRA member or person associated with the FINRA member solely to one or more of the following types of investors:

- 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 Securities Act Rule 144A;
- investment companies, as defined in Section 3 of the Investment Company Act;
- an entity composed exclusively of qualified institutional buyers;
- banks, as defined in Section 3(a)(2) of the Securities Act;
- employees and affiliates, as defined in Rule 5121, of the issuer;
- knowledgeable employees as defined in Investment Company Act Rule 3c-5;
- eligible contract participants, as defined in Section 3(a)(65) of the Exchange Act; and
- accredited investors as defined in Rule 501(a)(1), (2), (3) or (7) of the Securities Act.