
FINRA Announces Effective Date for New Rule 5123 – Required Filings of Private Placements of Securities

by Louis A. Bevilacqua

On September 5, 2012, the Financial Industry Regulatory Authority, or FINRA, issued Regulatory Notice 12-40, which notified FINRA members of the December 3, 2012 effective date for FINRA Rule 5123, captioned “Private Placements of Securities.”

The rule was approved by the SEC on June 7, 2012 and requires each FINRA member firm that sells an issuer’s securities in a private placement, subject to several exemptions, to file with FINRA a copy of any private placement memorandum, term sheet or other offering document the firm used within 15 calendar days of the date of sale, or indicate that it did not use any such offering documents. This 15-day filing requirement tracks the Form D filing requirement for issuers. Member firms will also be required to file any materially amended versions of documents that they originally filed. The rule applies prospectively to private placements that begin selling efforts on or after the December 3, 2012 effective date.

Member firms will be required to file the required offering documents electronically with FINRA through the FINRA Firm Gateway, 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. The filing system will allow a member firm to submit a filing on behalf of other member firms involved in the sale of the private placement.

Filings with FINRA under Rule 5123 are considered “notice” type filings. Accordingly, FINRA will not respond to these filings with a comment letter or provide a clearance letter. FINRA will accord confidential treatment to all documents and information filed pursuant to Rule 5123. Rule 5123 also provides member firms with a method to apply for an exemption from its provisions for good cause pursuant to the Rule 9600 Series.

According to FINRA, Rule 5123 is part of a multi-pronged approach to enhance oversight and investor protection in private placements. Rule 5123 complements FINRA’s prior guidance on a member firm’s responsibility to conduct a reasonable investigation of private placement issuers in Regulatory Notice 10-22.

Rule 5123 broadly defines “private placement” as a non-public offering in reliance on an available exemption from registration under the Securities Act of 1933, as amended, or the Securities Act. Rule 5123, however, provides several exemptions from this definition of private placement that substantially narrow the scope of the rule. Following is a list of some of the exemptions:

- Offerings made 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 of 1940, or the Investment Company Act;
 - Qualified Institutional Buyers, or QIBs, as defined in Securities Act Rule 144A;
 - An entity composed exclusively of QIBs;
 - Investment companies, as defined in Section 3 of the Investment Company Act;
 - Banks, as defined in Section 3(a)(2) of the Securities Act;
 - Employees and affiliates of the issuer, as defined in FINRA Rule 5121;
 - Knowledgeable employees as defined in the Investment Company Act Rule 3c-5;
 - Accredited Investors described in Securities Act Rule 501(a)(1), (2), (3) or (7) (i.e., institutional accredited investors);
- Offerings of exempted securities, as defined in Section 3(a)(12) of the Securities Exchange Act of 1934, as amended, or the Exchange Act;
- Rule 144A or Regulation S offerings;
- Offerings of non-convertible debt or preferred securities by issuers that are eligible to use Form S-3 or Form 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;
- Business combination transactions as defined in Securities Act Rule 165(f);
- Offerings of registered investment companies; and
- Offerings filed with FINRA under Rules 2310 (Direct Participation Programs), 5110 (Corporate Financing Rule-Underwriting Terms and Arrangements), 5121 (Public Offerings of Securities With Conflicts of Interest) and 5122 (Private Placements of Securities Issued by Members), or exempt from filing thereunder in accordance with Rule 5110(b)(7).

It is worth noting that not all private placements that are limited to accredited investors will be exempt from the filing requirements of Rule 5123. Only offerings limited to types of accredited investors, such as institutional accredited investors or qualified purchasers, will qualify for an exemption. Offerings that include some small venture capital “sidecar” funds might not qualify as exempt if those funds do not each have more than \$5 million in assets or if they were formed for the specific purpose of acquiring the securities offered. The solicitation by a member firm of individual accredited investors in a typical Regulation D private placement of equity securities will render the placement ineligible for the exemption, unless all of the individuals fall within one of the other exempted categories (e.g., if they are all employees or directors of the issuer).

Member firms should review their internal policies and consider making changes to those policies and adopt procedures to better track the types of investors that participate in private placements that they handle for their issuer clients. Such new policies and procedures will assist member firms to comply with the new rule.

If you have questions, please contact the Pillsbury attorney with whom you regularly work or the author:

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