

Proposed FINRA Rule 5123: Disclosure in Private Placements

November 2, 2011

The SEC recently solicited a second round of comments on the proposed new FINRA rule governing private placements. Rule 5123 would require FINRA members and associated persons participating in private placements of securities to provide detailed disclosure to investors prior to sale. A "private placement" is broadly defined to include any offering "in reliance on an available exemption for registration under the Securities Act." The proposed rule applies not only to those who sell or offer securities, but also to those who "participate" in the offering by helping to prepare a PPM, term sheet or other disclosure document. With this second-round proposal, adoption should now occur in due course, likely in the first half of 2012. Issuers and broker-dealers should begin to take the requirements into account in planning a private placement.

The required disclosure includes the anticipated use of offering proceeds, as well as the amount and type of offering and compensation provided to sponsors, finders, consultants, members and others associated with the offering. If no PPM or term sheet is used, a FINRA member must draft a document including this disclosure and provide it to investors prior to sale. Any PPM, term sheet or other disclosure document (including exhibits) must be filed with FINRA no later than 15 calendar days after the date of the first sale (which is consistent with the timing for filing a Form D under Regulation D with the SEC). Material amendments and amendments to the disclosures mandated by the proposed rule must be filed no later than 15 calendar days after they are provided to investors. Filings must be made by each member participating in an offering—so if three FINRA members participate, there would be three separate filings. The filings are only "notice" filings—they will be treated confidentially, and FINRA will not comment on or otherwise approve or disapprove of the offering.

Importantly, FINRA has backed away from some disclosure requirements previously proposed, including requiring that at least 85% of the proceeds raised be used for the business purposes described in the disclosure document. FINRA also has backed away from the previously proposed requirement that members file information with FINRA by the time an offering document is provided to any investor.

Certain offerings, including offerings only to certain purchasers, are exempt from the proposed rule—for example, offerings made under Securities Act Rule 144A; offerings only to employees or affiliates of the issuer and offerings of exempt securities under Section 3(a)(12) of the Exchange Act. FINRA members also are permitted to apply for exemption from any provision of proposed Rule 5123 under FINRA's Rule 9600 Series.

FINRA views its Proposed Rule 5123 as being consistent with its commitment to educating investors, and providing them with the means to make informed investment decisions. It also increases FINRA's ability to monitor members' actions from an enforcement point of view.

The implementation date of the proposed rule will be announced by FINRA no later than 90 days following SEC approval. The implementation date will be no more than 180 days following SEC approval.

Please feel free to contact us if you would like more information about proposed Rule 5123, or to discuss how it may impact your next private placement.

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