

Client Alert

Latham & Watkins
Corporate Department

FINRA Announces New Notice Filing Obligations for Certain Private Placements

On September 6, 2012, the Financial Industry Regulatory Authority, Inc. (FINRA) announced that FINRA Rule 5123 will become effective on December 3, 2012.¹ The new rule requires a FINRA member (a Member Firm) that sells securities in certain private placements to file certain information with FINRA within 15 days following the date of first sale, subject to an extensive set of exemptions from the filing requirement (which includes private offerings to most types of institutional investors), as outlined below. As adopted, FINRA Rule 5123 represents a significant revision from the original proposal and the impact will be limited primarily to private placements involving individual accredited and non-accredited investors.

Background

As originally proposed in October 2011, Rule 5123 was intended to be an expansion of existing FINRA Rule 5122² and prescribed requirements for private placement offering documents for a significant number of private offerings. FINRA stated that these new requirements were intended as part of a "multi-pronged approach to enhance oversight and investor protection in private placements."³ As initially proposed, the rule required an offering document (*i.e.*, a private placement memorandum, term sheet, or other disclosure documentation relating to the offering) including disclosure of the intended use of proceeds, offering expenses and the amount of compensation that would be received by the Member Firm and its associated persons in the offering to be provided to each investor and filed with FINRA prior to providing it to potential investors. If an issuer did not intend to provide an offering document containing these required disclosures, the Member Firm would be required to provide its own disclosure document to investors consistent with the rule's requirements. In addition, under the proposed rule, at least 85 percent of the offering proceeds were required to be actually used for the business purposes described in the offering document, rather than for any costs related to the offering, any commissions, or any other cash or non-cash sale incentives or discounts.

The Final Rule

As a result of substantial feedback from the industry, the final rule is significantly less burdensome than the initial proposal and includes an extensive list of exemptions. As approved, Rule 5123 requires that a Member Firm selling securities

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in a private placement file any offering documents distributed to potential investors with FINRA within 15 days following the date of first sale. Any material amendments to those originally filed documents must also be filed with FINRA. If no offering documents are used in connection with a particular offering, then the Member Firm need only indicate such absence in its FINRA filing. Each Member Firm that participates as a placement agent in the offering is responsible for filing under Rule 5123, but one Member Firm may be designated to file on behalf of the other participating Member Firms so long as all participating Member Firms are listed in the FINRA filing. The final rule contains neither the specific disclosures nor the use of proceeds requirements of the original proposal. All filings must be submitted electronically by Member Firms through the FINRA Firm Gateway. Offering documents filed with FINRA under this rule will not be approved or commented upon by FINRA. All information filed pursuant to the requirements of Rule 5123 will receive confidential treatment by FINRA.

Available Exemptions

Final Rule 5123 expands the list of exemptions to include offerings solely to one or more of the following purchasers:

- Institutional accounts⁴
- Qualified purchasers⁵
- Qualified institutional buyers⁶
- Investment companies and banks
- Employees and affiliates⁷ of the issuer
- Knowledgeable employees⁸
- Eligible contract participants⁹
- Institutional "accredited investors,"¹⁰ including certain banks, brokers, insurance companies, private business development companies, corporations, business trusts, certain partnerships and Internal Revenue Code Section 501(c)(3) organizations, and certain trusts, but *not including* natural persons.

Notably absent from this list is an exemption for offerings to an individual who qualifies as an accredited investor.¹¹ If such persons do not otherwise qualify under one of the other available exemptions listed above (including, *e.g.*, knowledgeable employees or qualified purchasers), then the offering will be subject to the filing requirements of Rule 5123.

Other types of exempt offerings under the Rule include:¹²

- Offerings of exempted securities¹³
- Offerings under Securities Act Rule 144A or Regulation S
- 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

Endnotes

- ¹ FINRA Regulatory Notice 12-40 (September 2012).
- ² FINRA Rule 5122 requires Member Firms to file offering documents for private placements of securities issued by the Member Firm or its control affiliates and prescribes certain disclosures that must be included in such documents.
- ³ FINRA Regulatory Notice 12-40. See also FINRA Regulatory Notice 10-22 (April 2010) which reminds Member Firms of their obligations with respect to reasonable investigation of issuers and the suitability and anti-fraud requirements under the federal securities laws.
- ⁴ The term “institutional accounts” is as defined in FINRA Rule 4512(c), and includes a bank, savings and loan association, insurance company or registered investment company; an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.
- ⁵ The term “qualified purchasers” is as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940 (the Investment Company Act).
- ⁶ The term “qualified institutional buyers” is as defined in Securities Act Rule 144A.
- ⁷ The term “affiliates” is as defined in FINRA Rule 5121, which incorporates this broader definition of control.
- ⁸ The term “knowledgeable employees” is as defined in Rule 3c-5 of the Investment Company Act.
- ⁹ The term “eligible contract participants” is as defined in Section 3(a)(65) of the Securities Exchange Act of 1934 (the Exchange Act).
- ¹⁰ For purposes of Rule 5123, the term “accredited investors” is as described in Rule 501(a)(1), (2), (3) or (7) under the Securities Act of 1933 (the Securities Act).
- ¹¹ See Securities Act Rule 501(a)(4), (5), and (6).
- ¹² The additional exemptions are as follows: offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act and certain debt securities sold by members pursuant to Section 4(2) 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 securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(11) of the Commodity Exchange Act; business combination transactions as defined in Securities Act Rule 165(f); offerings of registered investment companies; standardized options, as defined in Securities Act Rule 238; and offerings filed with FINRA under FINRA Rules 2310, 5110, 5121 and 5122, or exempt from filing thereunder in accordance with Rule 5110(b)(7) and (8)(E).
- ¹³ The term “exempted securities” is as defined in Section 3(a)(12) of the Exchange Act.

If you have any questions or comments about this *Client Alert*, please contact the authors below or your regular Latham & Watkins contact.

Dana G. Fleischman
+1.212.906.1220
dana.fleischman@lw.com
New York

Stephen P. Wink
+1.212.906.1229
stephen.wink@lw.com
New York

Ellen M. Creede
+1.212.906.1757
ellen.creede@lw.com
New York

Gail S. Neely
+1.212.906.4578
gail.neely@lw.com
New York

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