

## FINRA Issues Guidance on Retail Communications in Private Placements

*The guidance highlights certain issues identified by FINRA regarding member firm communications to retail investors in private placement offerings.*

On July 1, 2020, the Financial Industry Regulatory Authority (FINRA) issued [Regulatory Notice 20-21](#) (RN 20-21) to assist member firms in their creation, review, approval, distribution, and use of retail<sup>1</sup> communications<sup>2</sup> regarding privately placed securities.

FINRA prefaced RN 20-21 by stating that its recent review of retail communications by member firms in connection with private placement offerings has revealed deficiencies under FINRA Rule 2210, which addresses member communications with the public. FINRA noted that while private placement investments are generally speculative, illiquid, and attended by higher risk than publicly available investments, many of the private placement-related communications it reviewed did not balance claims regarding the investment's benefits by disclosing these risks. FINRA further noted that certain communications also contained false, misleading promissory statements or claims such as assertions about the likelihood of a future public offering; claims about the issuer's new or untried business model; inaccurate assertions regarding regulation or the risks of the offering; or predictions of investment performance prohibited by FINRA rules.

FINRA proceeded to set forth certain concrete guidelines specific to retail communications for private placements. This *Client Alert* summarizes these guidelines and their import for broker-dealers effecting private placement transactions.

### Balanced Presentation of Risks and Investment Benefits

FINRA reminded members that FINRA Rule 2210 requires that all broker-dealer communications be "fair and balanced" and based on principles of fair dealing and good faith.<sup>3</sup> Specifically with respect to private placements, FINRA stated that retail communications that discuss a private placement investment's benefits, value proposition, or potential returns must also discuss the various attendant risks of the private placement investment, such as its potential to lose value, its lack of liquidity, and its speculative nature. FINRA stated that such risk disclosure must be contained in or integrated with the same retail communication that has the positive statements, and cannot be set forth in a separate

document or location than the retail communication (such as, for example, the private placement memorandum (PPM) or website).

## Reasonable Forecasts of Issuer Operating Metrics

FINRA clarified that despite FINRA Rule 2210's prohibition on projections, retail communications are not prohibited from conveying certain information regarding the issuer's plans and financial position, including *reasonable* forecasts of "issuer operating metrics" (e.g., forecasted sales, revenues, customer acquisition numbers, etc.). FINRA specifically outlined various factors that member firms should consider when determining the reasonableness of such forecasted metrics, including the timeframe of projections and their commensurability with external market and industry norms. FINRA further highlighted that the presentation of such forecasted metrics should include clear explanations of key underlying assumptions and the risks that may impede their achievement. FINRA also stated that metrics such as cash flow or revenue should not be characterized as guaranteed or certain even if they have a contractual basis<sup>4</sup> and that such metrics should not be used to depict investment returns to an investor.<sup>5</sup>

## Internal Rate of Return

FINRA clarified that the internal rate of return (IRR) of an investment program can be used as a performance metric in retail communications with respect to that investment program in certain limited situations. Specifically, FINRA stated that in order for the inclusion of IRR to be justified, the investment program must be "completed" (e.g., the holding matured or all holdings in the investment pool have been sold). FINRA emphasized that the use of IRR in connection with privately placed new investment programs that have no operations or that operate as a blind pool would be inconsistent with the prohibition on unwarranted forecasts or projections in FINRA Rule 2210(d)(1)(F).

## Third-Party Prepared Materials

FINRA re-emphasized its prior guidance under [Regulatory Notice 10-22](#) (April 2010) that "[a member firm] that assists in the preparation of a private placement memorandum or other offering document should expect that it will be considered a communication with the public by that [member firm]" for purposes of FINRA Rule 2210 and, conversely, that "sales literature concerning a private placement that a [member firm] distributes will generally be deemed to constitute a communication by that [member firm]." FINRA specifically stated that it has observed some private placement memoranda are presented as one electronic file that also contains promotional content distinguishable from the informational content of the PPM and that such promotional content nonetheless constitutes a retail communication by the member, regardless of whether it is packaged together with the PPM or issued as a stand-alone document.

## Distribution Rates

FINRA cautioned that even if an issuer funds a portion of its distributions through the return of principal or loan proceeds, its distributions should not be characterized as fixed income in retail communications through the use of terms such as "yield" or "current yield" or otherwise.

## Conclusion

RN 20-21 reflects that FINRA is looking more closely at retail communications by broker-dealers regarding private placements and expects to see clear disclosures in these retail communications regarding the particularly speculative and illiquid nature of the private placements. RN 20-21 further establishes some discrete guardrails around the types of metrics that can and cannot be used in private placement retail communications to be in compliance with FINRA Rule 2210.

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**Endnotes**

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- <sup>1</sup> “Retail investor” is defined in FINRA Rule 2210(a)(6) as “any person other than an institutional investor, regardless of whether the person has an account with a member.” The term “institutional investor” is defined in FINRA Rule 2210(a)(4) to include, among others, any person that qualifies as an “institutional account” under FINRA Rule 4512(c), which, in turn, includes “any person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least US\$50 million.” This is in contrast to the definition of “retail customer” for the purposes of SEC Regulation Best Interest, which captures all natural persons and their legal representatives without creating an exclusion for natural persons with more than US\$50 million in assets. Rule 2210(a)(4) further reminds member firms that “[n]o member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any retail investor.”
- <sup>2</sup> “Retail communication” is defined in FINRA Rule 2210(a)(5) as “any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period.”
- <sup>3</sup> See Rule 2210(d)(1)(A).
- <sup>4</sup> See Rule 2210(d)(1)(B).
- <sup>5</sup> See Rule 2210(d)(1)(F).