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New FINRA Filing Requirements for Private Placement Recommendations; More Private Offering Regulatory Restrictions Likely

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FINRA Rules

On July 15, 2021, FINRA announced^[1] that it has updated its rules regarding the offering of private placement securities to expand the existing requirement that each broker-dealer that issues and/or sells a private placement submit a copy of the offering documents (and any subsequent, materially amended versions thereof) before the documents' first use or the securities' first sale^[2] or notify FINRA that no such offering documents were used.^[3] The amended rules, effective October 1, 2021, now require any retail communication that "promotes or recommends [a] private placement" also be filed with FINRA prior to the first use or sale.^[4]

Key definitions relevant to the new rules include the following:

- A "retail communication" includes any written communication (including electronic) that is distributed or made available to more than 25 retail investors within any 30 calendar-day period.^[5]
- A "retail investor" is any person other than an institutional investor, regardless of whether the person has an account with the broker-dealer.^[6]
- An "institutional investor" is a bank, savings and loan association, insurance company, or registered investment company, a registered investment adviser, any person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million,^[7] a governmental entity, employee benefits plan, qualified plan that in aggregate has at least 100 participants, broker-dealer and its registered persons, or person acting on behalf of an institutional investor.^[8]

Likely Forthcoming Regulations

While recent months have seen a surge in IPO activity,^[9] the majority of capital raised in recent years has been through private offerings.^[10] Typically, an investor must be "accredited" to participate in private offerings. Nearly a year ago, on August 26, 2020, the U.S. Securities and Exchange Commission ("SEC") adopted an expanded definition of an accredited investor,^[11] against the protestations of investor protection advocates, including NASAA.^[12] The expansion may be short-lived.

FINRA's further expansion into overseeing the sale of private placement securities is likely only the beginning of securities' regulators expansion into the space. Chairman Gensler's near-term agenda for the SEC, released on June 11, 2021, includes seeking public comment on various aspects of the regulations governing exempt (*i.e.*, private placement) offerings, including the accredited investor definition^[13] and the information that private placement issuers are required to provide to the SEC and to prospective investors.^[14] We recommend that broker-dealers and other industry participants (*e.g.*, investment advisers, issuers) that assist with or conduct private offerings and investments in private offerings monitor regulatory developments in this area closely.

If you have any questions about the impact of FINRA's expanded oversight over private offerings, or any other questions regarding the regulation of broker-dealers, investment advisers, investment companies or securities issuers, please feel free to contact us.

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[1] FINRA, Regulatory Notice 21-26, Private Placement Retail Communications, FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements (July 15, 2021), available at <https://www.finra.org/sites/default/files/2021-07/Regulatory-Notice-21-26.pdf>.

[2] FINRA Rule 5122 relates to the offering of private placement securities issued by a broker-dealer and requires that offering materials be filed at or before the first time the documents are provided to a prospective investor. FINRA Rule 5123 relates to the offer and sale of private placement securities generally and requires the filing of offering materials within 15 calendar days of the first sale.

[3] The new rules have been in progress for some time. See, e.g., Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities), 86 FR 31764, available at <https://www.federalregister.gov/documents/2021/06/15/2021-12474/self-regulatory-organizations-financial-industry-regulatory-authority-inc-order-approving-proposed> (describing that in October 2020, FINRA filed with the Securities and Exchange Commission the proposed rule change, which was available for comment beginning in November 2020).

[4] FINRA Rules 5122 and 5123.

[5] FINRA Rule 2210(a)(5).

[6] FINRA Rule 2210(a)(6).

[7] FINRA Rule 4512(c).

[8] FINRA Rule 2210(a)(4).

[9] Isabelle Lee, *The \$171 Billion of US IPOs in 2021 is Already a Full-Year Record*, Markets Insider (June 16, 2021), available at <https://markets.businessinsider.com/news/stocks/ipo-volume-2021-spac-171-billion-us-capital-markets-boom-public-6>.

[10] See, e.g., Scott Bauguess et al., Securities and Exchange Commission, *Capital Raising in the U.S: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017* (Aug. 2018), available at https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf.

[11] See our blog post at <https://www.kilpatricktownsend.com/Blog/Investment-Management-and-Broker-Dealer/2020/8/SEC-Adopts-Amendments-to-Accredited->

[Investor-Definition](#), and SEC, Final Rule: Amending the “Accredited Investor” Definition (Aug. 18, 2020), available at <https://www.sec.gov/news/press-release/2020-191>.

[12] See NASAA, Statement on the SEC’s Amendment of Accredited Investor Definition (Aug. 26, 2020), available at <https://www.nasaa.org/55611/nasaa-statement-on-the-secs-amendment-of-accredited-investor-definition/>; see also NASAA, Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment (Sep. 19, 2019), available at <https://www.nasaa.org/52538/examining-private-market-exemptions-as-a-barrier-to-ipos-and-retail-investment/>.

[13] The SEC declined to lower the financial thresholds for accredited investor status when it amended the definition in 2020. A Gensler-led Commission is likely to consider increasing the existing financial thresholds. The pre-stage rule proposal reads: “The Division is considering recommending that the Commission seek public comment on ways to further update the Commission’s rules related to exempt offerings to more effectively promote investor protection, including updating the financial thresholds in the accredited investor definition, ensuring appropriate access to and enhancing the information available regarding regulation D offerings, and amendments related to the integration framework for registered and exempt offerings.” Securities and Exchange Commission, Exempt Offerings, RIN 3235-AM85, Pre-Rule State, available at <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202104&RIN=3235-AM85> (emphasis added).

[14] SEC, Press Release, SEC Announces Annual Regulatory Agenda (June 11, 2021), available at <https://www.sec.gov/news/press-release/2021-99>.