

Alerts

FINRA Seeks to Expand Disclosure Requirements and Limit Compensation for Private Placement Offerings

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The Financial Industry Regulatory Authority (FINRA) has proposed changes to its existing Rule 5122 that could significantly alter the disclosure requirements and conduct of private placement offerings. The text of the proposed rule change is available in FINRA Regulatory Notice 11-04.

Among other proposed changes, FINRA is seeking to regulate the amount of compensation that may be obtained by broker-dealer firms acting as selling agents, placement agents or finders in private placement offerings. The proposed rule would limit offering costs and compensation to no more than 15 percent of the gross proceeds of an offering. Compensation and costs include commissions, discounts and offering expenses. The proposal does not state whether reimbursement or payment of the broker-dealer's legal fees would count toward the 15 percent compensation limitation or how equity-based compensation would be valued. The proposal also does not state whether the legal and accounting fees incurred by the issuer in connection with the private placement would be included in the 15 percent limitation calculation.

Offerings made to institutional accounts, qualified institutional buyers and qualified purchasers would be exempt from the rule; however, there is no exemption for offerings to accredited investors. Further, offerings made pursuant to SEC Rule 144A would be exempt from the rule.

The proposed amendments would also require that FINRA member firms file offering documents with FINRA at the time of or prior to an offering's initial use.

Members of LeClairRyan's Financial Services Litigation and Regulation team and the Venture Capital team believe the proposed changes could have an adverse effect on private placement offerings and may deter broker-dealer firms from engaging in private placements. In addition, the changes would likely further limit the number of broker-dealer firms willing to undertake private placement offerings for start-up, venture-backed, micro and small-cap companies. These companies already face numerous hurdles to their capital raising efforts. Further, although FINRA believes that the filing requirement for offering documents will not affect the timing of an offering, the offering document will be subject to review and comment by FINRA. As a result, many broker-dealer firms will likely seek assurance that there are no comments prior to commencing marketing activities. We believe that the potential for comments will likely place broker-dealer firms in the untenable position of requiring more detailed disclosure, increasing legal fees and yet reducing potential compensation and reimbursement of costs.

The comment period on the proposed rule expires on March 14, 2011. Learn how to submit a comment. If you have questions about the proposed rule, please contact William Despo, Brian Daughney or James Seery.

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