November 22, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
rule-comments@sec.gov

Re: File Number SR-FINRA-2020-038

Dear Ms. Countryman:

Scopus Financial Group, the preeminent provider of regulatory guidance to the financial services industry, appreciates the opportunity to comment on FINRA's proposed amendments to Rule 5122 and Rule 5123 to require broker-dealers to file retail communications concerning certain private placements.[1]

The proposed amendments are justified. In its rule filing FINRA describes the abnormally large percentage of misleading retail communications in the private placement market. By requiring that they be filed and subjected to triaged review FINRA will better ensure that retail communications used by broker-dealers in retail private placements are fair, balanced and not misleading. Scopus heartily supports the proposed amendments.

Scopus also recommends that FINRA and the Commission adopt other bold measures to protect retail investors in the private placement market. We respectfully offer three suggestions for FINRA and two for the Commission.

[1] The founder of Scopus Financial Group, Thomas M. Selman, is a former Executive Vice President for Regulatory Policy and Legal Compliance Officer of FINRA. In submitting these comments neither Scopus nor Mr. Selman represents any client or other person – other than the public investor.

1. Scopus' Suggestions for FINRA

Scopus has three suggestions for FINRA to protect retail investors.

First, FINRA should combine Rule 5122 and Rule 5123 into a single rule governing retail distribution of private placements by FINRA members. The existence of two rules arose from an historical anomaly. FINRA's adoption of Rule 5122 was a measured step to regulate retail private placements in which a broker-dealer is the issuer. Although it did not contemplate adoption of a requirement for all retail private placements sold by a broker-dealer, FINRA's experience with Rule 5122 paved the way for Rule 5123. Today there is no need for two rules. Their different filing requirements and exemptions must confuse FINRA members, and these divergences serve little purpose. The more sensible provisions in each rule should be combined into one rule.

Second, FINRA should retain at least one requirement from Rule 5122, that a broker-dealer disclose to each retail investor information about the use of offering proceeds, offering expenses, and selling compensation. FINRA originally proposed this disclosure requirement in Rule 5123 but dropped it before the Commission approved the rule. Such a requirement is justified by the history of problems in the private placement market since FINRA adopted Rule 5123. A disclosure requirement would better ensure that retail investors are given a record concerning a few essential terms of the offering.

Third, FINRA should amend Rule 2210 so that it applies to private placement memoranda, term sheets, and other offering documents in retail private placements. It is well and good to ensure that FINRA staff can review retail communications that are already subject to Rule 2210. This is what the proposed amendments would do. It would be even better to ensure that offering documents that resemble retail communications are fair, balanced and not misleading.

FINRA has stated that in some situations a private placement memorandum could be subject to Rule 2210, such as when the broker-dealer has helped prepare it.[2]

[2] *See, e.g.,* Regulatory Notice 10-22:

> [A member] 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] for purposes of … Rule 2210, FINRA's advertising rule. If a private placement memorandum or other offering

There is no legal definition of a "private placement memorandum" or even a common understanding of the term that could allow one to readily distinguish any PPM from a retail communication subject to Rule 2210. Many retail PPMs are carefully crafted disclosure documents. Others are souped-up promotional brochures. Moreover, it is not always clear when a broker-dealer has been deemed to have assisted in the preparation of the PPM.

To resolve doubt and protect retail investors, FINRA should subject PPMs, term sheets, and other offering documents used by a broker-dealer in retail private placements to Rule 2210(d)(1), the general content standards. Scopus recognizes that some provisions of Rule 2210 are technical in nature and that is infeasible to require that FINRA members ensure that every PPM comply with all aspects of that rule. For that reason, we recommend that FINRA amend Rule 2210 to require that only paragraph (d)(1) apply to PPMs, term sheets and other offering documents that a broker-dealer uses in a retail private placement.

2. Scopus' Suggestions for the Commission

We have two suggestions for the Commission, each resting upon a fundamental fact: *The distribution of private placements by a FINRA member is well-regulated. The direct sale of private placements by an issuer is not.*[3]

For example, broker-dealers -- but not issuers – must act in a purchaser's best interest and send only retail communications that are fair, balanced and not misleading.

Of the 20,000 new Regulation D filings with the SEC each year, only about 2,000 are also filed with FINRA. The Commissions' data concerning the private placement market does not reveal how many of the 18,000 direct-sold private placements are made to retail investors, but one can assume that it is a large percentage. These thousands of retail investors should be afforded basic protections like Rule 5122 and Rule 5123. Issuers should be required to disclose,

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> document presents information that is not fair and balanced or that is misleading, then the [member] that assisted in its preparation may be deemed to have violated … Rule 2210.

Regulatory Notice 10-22, https://www.finra.org/rules-guidance/notices/10-22 (2010).

[3] In addition to these two suggestions, we respectfully recommend that the Commission support FINRA's adoption of our three suggestions to FINRA in this letter.

at a minimum, the use of offering proceeds and the offering expenses associated with the offering. The Commission should require that issuer-prepared PPMs, term sheets, offering documents, and retail communications comply with minimal content standards and that they be filed for review.[4]

Second, the Commission's regulation of private placements under the Securities Act of 1933 should recognize that the Commission and FINRA regulate the retail distribution of private placements by broker-dealers. The antifraud provisions of the federal securities laws, Regulation Best Interest and FINRA rules require that a broker-dealer conduct reasonable due diligence on any private placement that it recommends.[5] The filing requirements in Rule 5122 and Rule 5123 help ensure that broker-dealers fulfill this responsibility. The Securities Act protections afforded to retail investors should be scaled according to whether a private placement is distributed by a broker-dealer subject to a due diligence responsibility or an issuer that is marketing its own deal.[6] For example, the Commission could adopt a stricter definition of "accredited investor" when a private placement will be sold directly by an issuer.

[4] If the Commission lacks the capacity to adopt a review program, it could build upon FINRA's existing program. For example, the Commission could provide a safe harbor from filing for any offering document filed with FINRA. This safe harbor would require Commission support for a FINRA program to review filings by nonmember issuers; it would be like the safe harbor for investment company advertisements. *See* Securities Act Rule 497(i). To ensure that FINRA has the resources to accommodate so many filings, the Commission should permit FINRA to charge a reasonable fee for each filing.

[5] *See, e.g.,* Regulatory Notice 10-22, https://www.finra.org/rules-guidance/notices/10-22 (2010).

[6] *See generally* Selman, "Sidestepping the Rat Holes: Investment Risk and Securities Law," Harvard Business Law Review (2018), https://www.hblr.org//wp-content/uploads/sites/18/2018/04/Selman_Final.pdf. The Commission similarly proposed but did not adopt amendments to its rules that would have relied upon broker-dealer regulation in the distribution of leveraged and inverse exchange-traded funds. *See* SEC Release IC-33963, https://www.sec.gov/rules/proposed/2019/34-87607.pdf (2019).

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Scopus Financial Group appreciates the opportunity to comment on the proposed amendments. We would be happy to answer any questions that the Commission staff might have.

Sincerely,

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