Via Electronic Mail

December 4, 2020

Vanessa A. Countryman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Proposed Amendments to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) that Would Require Members to File Retail Communications Concerning Private Placement Offerings that are Subject to Those Rules' Filing Requirements, SR-FINRA-2020-038 (November 2, 2020)

Dear Ms. Countryman:

We appreciate this opportunity to comment on the Securities and Exchange Commission's ("Commission") Proposed Amendments to FINRA Rules 5122 and 5123 that Would Require Members to File Retail Communications Concerning Private Placement Offerings that are Subject to Those Rules' Filing Requirements (each an "Amendment" and, together, the "Amendments"). We understand FINRA's concerns about issues it has seen in the private placement market and its desire to exercise greater oversight of retail communications in that market. However, the Amendments include a request for comment on a proposed Amendment to Rule 5123 that we believe, as drafted, could impose significant burdens on FINRA member firms engaging in private placements and unduly limit retail investment in, and access to, promising private company securities. We are also concerned that the proposed Amendments could undermine the Commission's recent efforts to update the exempt offering framework, including by chilling potential members from using "testing the waters" communications and experimenting with Rule 506(c) following the Commission's recent changes. Below we suggest modifications to the Amendments to focus solely on substantive communications about an offering (not all communications, no matter how ministerial) that we believe would achieve FINRA's policy objectives but with a substantially lower burden on member firms.

Founded in 2013, EquityZen Inc. ("EquityZen") is an online marketplace for investors and shareholders in alternative assets. EquityZen is dedicated to democratizing access to investments that were previously out of reach for many. EquityZen often links employees from private companies who seek some liquidity with investors who would not otherwise be able to invest in the private companies prior to their initial public offerings. Over the past seven years, EquityZen has helped thousands of qualified investors to access more than 180 private, pre-IPO companies. EquityZen commonly offers investors interests in private investment funds that directly own shares of an underlying pre-IPO company.[1] Using private funds allows EquityZen to offer lower minimum investments (often $20,000 or $10,000 for first-time investors) for private placements than many other pre-IPO investment platforms. EquityZen's historical focus on the underserved market for retail investors makes it a frequent filer under Rule 5123.[2] As a result, we believe we can offer some useful perspective on the potential impacts of the proposed Amendment to Rule 5123.

The Existing Investor Protection Framework and the Need to Assess the Impact of FINRA Regulatory Notice 20-21

The current investor protection framework is robust, with overlapping oversight of member firms by FINRA, the Commission's Office of Compliance Inspections and Examination ("OCIE"), and state securities regulators and enforcement authorities. For example, FINRA's Rule 2210 already requires member firms' communications to be fair, balanced and not misleading, and prohibits false, exaggerated, unwarranted or overly promissory statements. Existing Rule 2210 also requires pre-approval of all retail communications (those distributed or made available to

[1] A private fund's direct ownership of shares of an underlying company also helps minimize certain other risks to investors. For example, other pre-IPO investments can involve participation agreements or forward contracts, both of which can pose additional risks of non-delivery of shares to investors or that an underlying company does not recognize the transaction. Likewise, derivative contracts can pose additional risks of counterparty failure or of the derivative not performing as anticipated.

A private fund's direct ownership of shares does not eliminate all investment risks. Pre-IPO investments are illiquid investments that involve substantial risks, including the risk of loss, fluctuations in value and in returns. Not all pre-IPO companies will go public or get acquired, and not all IPOs or acquisitions will result in successful investments. EquityZen clearly discloses these risks to its customers.

[2] We note that EquityZen competes against some private fund sponsors active in the pre-IPO securities area that do not use a broker-dealer to distribute their funds. Increasing the cost of using a broker-dealer puts firms such as EquityZen at a competitive disadvantage to these self-distributing venture capital fund advisers.

more than 25 retail investors in any 30-day period) by a firm principal. Investor protection is also served by FINRA Rule 2010, requiring members to observe high standards and just and equitable principles of trade. Further, FINRA Rule 3110 already requires member firms to maintain effective systems of supervision, including the review of incoming and outgoing correspondence. FINRA already routinely examines member firms regarding their compliance with those rules, among others. State securities regulators actively examine broker-dealers, with a particular focus on private placements and related communications. And the Commission's own rules, OCIE examinations and, where necessary, enforcement personnel, also serve important functions in protecting investors, including those in private placement transactions.

To be sure, despite this array of oversight, FINRA's review of Advertising Regulation Department filings from 2017 through March 31, 2020 found issues with broker-dealer communications concerning private placements.[3] In addition to communicating directly with member firms and bringing enforcement actions where necessary and appropriate, FINRA also took another important step. On July 1, 2020, FINRA issued Regulatory Notice 20-21 (the "Notice"). The Notice advised member firms of FINRA's concerns regarding retail communications for private placements, including communications prepared by third parties, stressing the importance of balanced presentations of investment risks and rewards, reasonable forecasts and highlighting specific concerns around presentations of distribution rates and internal rates of return. FINRA has also repeatedly highlighted the Notice to members by email, in Small Firm conference calls and other mediums. Nonetheless, coming as it did in the middle of an eventful 2020, even many serious and responsible member firms may have implemented changes in response to the Notice only in recent months.

EquityZen applauds FINRA's concerted effort to foster uniform investor protections and raise standards through public actions applicable to all members active in a particular area, rather than on a one-off basis with individual firms.[4] With FINRA having taken the important step of issuing the Notice, we respectfully submit that it would be appropriate for the both Commission

[3] A FINRA spot check of private placement filings from two quarters in 2018 also appears to support the same conclusion.

[4] FINRA's use of Regulatory Notices to reach members on matters of concern is similar to the Commission's and OCIE's increased use of risk alerts to timely communicate observations and concerns to market participants and is similarly appreciated.

and FINRA to first assess the Notice's impact before deciding the extent to which further, potentially costly measures are required. In the alternative, we propose that Rule 5123 be modified to require members to file only those types of communications on which investors are likely to base an investment decision, rather than incorporating by reference the definition of "retail communication" found in FINRA Rule 2210. Drafting the Amendments to cross-reference Rule 2210 is likely to disproportionately increase administrative burdens for FINRA member firms engaged in private placements without offsetting benefits to retail investors.

The Potential Impact of the Proposed Amendment to Rule 5123 on Member Firms and Investors

Current Rule 5123 requires member firms to file with FINRA any "private placement memorandum, term sheet, or offering document" used in connection with the private placement of securities within 15 days of the date of first sale. If an investment does not have a private placement memorandum, the offering document must include disclosures of the intended use of the offering proceeds, the offering expenses, and the amount of selling compensation that will be paid to the member and its associated persons.

To avoid undue burden and expense, we respectfully submit that any expansion of the Rule 5123 filing requirement be limited to expressly requiring the filing of investor presentations (a/k/a pitch decks or slide shows), in addition to the current requirements for private placement memoranda, term sheets and other offering documents.

In our experience, investors are sufficiently likely to rely on such presentations in making investment decisions to warrant their inclusion in filings required by Rule 5123.[5] Of course, investors also commonly rely on any applicable private placement memorandum, term sheet or other offering document provided to understand the terms of the investment being offered, which are already covered by current Rule 5123.[6] In our experience, potential investors do not

[5] At EquityZen, 5123 filings commonly include a PDF of an online offering document, any private placement memorandum, subscription agreement or term sheet applicable to the offering and, if applicable, any investor presentation related to offering, as well as any other documents requested by FINRA.

[6] If the Commission and FINRA desire members to include investor presentations in 5123 filings, FINRA may also wish to update the explanation of an "offering document" in "Frequently Asked Questions (FAQ) About Private Placements," Question 10 (available on www.finra.org) to reference them.

commonly make important investment decisions based on "one-pagers" or similar short investment summaries, and as a result they are not commonly used at EquityZen.

We respectfully submit that the proposed requirement to file all retail communications concerning a private placement paints with too broad a brush. Any perceived incremental investor protection benefits that might result from requiring the inclusion of all retail communications concerning a private placement investment would be outweighed by the significant burdens associated with such a requirement.

EquityZen, like many firms, offers private placement investments to investors primarily through private funds, which can help reduce costs and lower minimum investment sizes for investors. Enabling investors to gain exposure to private companies at smaller investment sizes may also help investors increase diversification and reduce risk. Investments offered through private funds often involve more than 25 actual or potential members. One result is that many (perhaps most) routine communications by FINRA members related to a private fund offering are retail communications concerning a private placement, for which current rules already require pre-approval, monitoring and conformance to applicable standards.[7]

Many retail communications concerning a private fund offering are administrative in nature, and do not address the benefits and risks of an investment. For example, such retail communications concerning a private placement commonly include:

- Confirmation than investors' term sheets have been executed
- Confirmation that a signature, updated address, or other action is required by the investor was received[8]
- Reminders of actions required by the investor or signatures needed
- Updates regarding the status of the investment
- Confirmation of changes to an investor's investment size

[7] Most FINRA members firms already rely on third-party vendors to archive and monitor retail communications in a secure environment at additional expense, but FINRA Gateway and Firm Gateway are not currently able to integrate with such vendors.

[8] Requiring the filing of substantial numbers of retail communications in connection with Rule 5123 filings may also require FINRA devote substantial additional resources to ensuring the security of the personally identifiable information of numerous members' customers.

- Confirmation of an investor's place on a waitlist for an investment
- Updates regarding the waitlist for an investment
- Notifications regarding expected transaction steps or their timing, such as fund transfers
- Confirmations of when fund transfers will be initiated
- Reminders to update or confirm banking details
- Confirmations that funds for an investment have been received
- Confirmation that a private placement investment has closed

As a result, any perceived investor protection benefit in requiring member firms to identify and file all retail communications concerning a private placement would appear to be substantially outweighed by the necessary burden and expense. This is particularly so because many of the retail communications that would be required to be filed under the proposed Amendment take place after an investor has already made his, her or its investment decision.

Other retail communications concerning a private placement serve to alert a potential investor to the availability of, or provide a link to, a private placement memorandum, investor presentation or offering document, typically setting forth the terms of an offering and the risks and benefits of the investment, and which are often qualified by reference to such documents. For example, a member firm may email or otherwise notify an investor who has expressed interest in a particular investment that such an offering is available, typically by providing a notification and link to relevant documentation. If the underlying private placement memoranda, offering document or investor presentation to which such a retail communication links complies with applicable standards and is already included as part of the 5123 filing, we submit that any incremental investor protection benefit to including the linking retail communications is unlikely to outweigh the substantial administrative burdens and costs of including all such retail communications in 5123 filings. Member firms already dedicate substantial resources to pre-approving and monitoring retail communications. Requiring FINRA members to file all retail communications concerning a private placement offering would create an additional and duplicative administrative burden that is unnecessary in light of existing requirements.[9]

[9] The proposed Amendment does not specifically identify the 49 enforcement actions brought since January 1, 2014 that related to retail communications involving private placements. Nor is it immediately clear how many of those actions related to private placements that were subject to Rule 5123 (versus Rule 5122). A review of those

We estimate that a typical private placement offering using a pooled investment vehicle may have on average approximately 14 to 16 retail communications concerning that offering, the vast majority of which do not discuss the specific investment opportunity, its risks or its benefits. Because the proposed Amendment appears to significantly underestimate the number of retail communications that may concern a private placement offering, the expected costs and administrative burdens of the rule may be impacted by a factor of 7 to 8 times those projected. We do not believe there is a sufficient benefit to requiring a significant volume of retail communications to be included in filings under Rule 5123 given the expected volume.

Additional difficulties for members are presented by the Amendment's reliance on the definition of a retail communication. For member firms operating or affiliated with investment platforms that conduct multiple offerings, even routine messages concerning a private placement that are sent to only a subset of investors may be deemed retail communications based on the number of retail investors receiving them across multiple offerings within any thirty-day period.

A non-exhaustive list of standardized communications concerning a private placement offering that may be deemed retail communications could include:

- Communications to a private placement investor requesting a copy of a driver's license, passport or other government-issued photo ID
- Communications to a private placement investor using a legal entity requesting documents reflecting the formation of the entity and/or authority to sign on behalf of the entity
- Communications to a private placement investor using a legal entity requesting information concerning the beneficial owners or control persons of the entity
- Communications to a private placement investor using an IRA or 401(k) regarding documentation required to consummate an investment through such an account
- Communications to a private placement investor using a trust regarding the formation of the trust, the identity of trustee(s) and the authority to consummate the transaction
- Communications to a private placement investor requesting confirmation or clarification of an investor's investment objectives or other information required by Regulation Best Interest and/or FINRA's suitability rule

enforcement actions may reveal that substantially all of those enforcement actions could still have been brought had the filing requirements for Rule 5123 been limited to investor presentations, private placement memoranda, term sheets and other offering documents.

To be sure, communications regarding required documentation are important, and EquityZen maintains those communications as required under the SEC and FINRA record-retention rules and makes them available for SEC and FINRA examinations. That said, requiring the filing of all retail communications concerning such matters in private placements would not seem to meaningfully address the concerns identified by FINRA.

Each of the concerns above and types of communications listed may also be conveyed through different mediums. For example, members may provide investors who consent to receive them with push notifications via mobile app instead of, or in addition to, email notifications. Each of these formats may have different content limitations, and may technically constitute different retail communications, increasing the administrative and technical burden of filing all retail communications concerning a private placement across different permitted communication channels.

Incorporating the definition of retail communications under FINRA Rule 2210 also creates a logistical complexity for member firms that will make compliance more difficult. Rule 2210 applies to retail communications sent within any 30-day period, meaning that a 30-day window must be analyzed before and after any communication event. As a result of incorporating Rule 2210 by reference into the Amendments, member firms will face additional uncertainty regarding which retail communications must be included when they file documents required by Rules 5122 and 5123. While a member firm may well be able to determine whether it has sent a particular communication to 25 or more persons in the past 30 days, doing so is more difficult on a forward-looking basis. As a result, many member firms can be expected to include additional retail communications that may be sent to 25 or more persons in the next 30 days.

The Potential Impact of the Proposed Amendment to Rule 5123 on the Commission's Private Securities Offering Reform Initiatives

We are concerned that the proposed Amendment to Rule 5123 may also negatively impact recent Commission reforms to update the existing framework for exempt offerings, including the exemptions available for private placements.

The Commission recently introduced final rules updating the exempt offering framework in important respects. For example, the Commission recently adopted a final rule permitting "testing-the-waters" communications, allowing market participants to explore potential investor interest before deciding under which exemption from registration an offering may proceed. By announcing a new filing requirement on retail communications concerning a private placement before the Commission's change has gone into effect, the Amendment can be expected inadvertently to deter member firms from making use of testing-the-waters communications, and to conflict with the Commission's intent in adopting its new rules. Because "testing the waters" communications always will be followed by formal offering materials before any investor makes any investment decision, we suggest that FINRA exempt "testing the waters" communications from the new proposed 5123 filing requirements.

Similarly, the Commission recently introduced reforms concerning the subsequent reverification of an investor's accredited investor status under Rule 506(c). One potential benefit of Rule 506(c) offerings is that they may permit more efficient capital formation through the use of general solicitation. Because communications regarding Rule 506(c) offerings may also frequently be deemed retail communications, the Amendment can be expected substantially to deter some member firms from experimenting with or making use of Rule 506(c)—thereby frustrating the Commission's changes before they have taken effect.[10] As a firm that has looked closely at the potential benefits and costs of relying on Rule 506(c) for at least some offerings, EquityZen's own experience is that the proposed Amendment poses a meaningful additional deterrent to such efforts.

We believe any negative impact on the Commission's rule changes for exempt offerings would be substantially ameliorated by limiting any expansion of the Rule 5123 filing requirement to investor presentations concerning the private placement, rather than all retail communications concerning a private placement. This would be in addition to the existing Rule 5123 filing requirements for private placement memoranda, term sheets and other offering documents.

[10] Likewise, the Commission addressed the fact that only an estimated 4.5 percent to 9 percent of Regulation D offerings historically have permitted non-accredited investors to invest. The Commission sought to explain the availability of such offerings by conforming the information requirements for Regulation D offerings that include non-accredited investors to those for exempt offerings under Regulation A. The Amendment can also be expected to deter at least some additional member firms from allowing greater participation by non-accredited investors.

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If you have any questions regarding the foregoing, please contact Chris Giampapa at (347) 966-4258. Thank you.

Sincerely,

EquityZen Inc.

By: Atish Davda
Atish Davda, Co-Founder & CEO

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