Private Placements and Offerings 19.00

Introduction

Private placements and offerings allow companies to raise outside capital without the registration requirements of a full offering.

19.01 Supervisory Responsibility

The designated principal is responsible for monitoring, supervising, and approving all private offering activities. The principal should review all documentation, reports, and information relating to the Firm's private placement activities including but not limited to:

- Suitability of all participants;
- Compliance with Regulation D;
- Delivery of all relevant disclosure documents;
- Customer account documentation;
- Approval of transactions.

Supervision

A firm that engages in Regulation D offerings must have supervisory procedures in accordance with FINRA Rule 3110 that are reasonably designed to ensure that the firm's personnel, including its registered representatives:

- engage in an inquiry that is sufficiently rigorous to comply with their legal and regulatory requirements;
- perform the analysis required by FINRA Rule 2111 (formerly Rule 2310);
- qualify their customers as eligible to purchase securities offered pursuant to Regulation D; and
- do not violate the antifraud provisions of the federal securities laws or FINRA rules in connection with their preparation or distribution of offering documents or sales literature.

The firm's procedures must be reasonably designed to ensure that each Regulation D offering is properly supervised before it is marketed to other firms or sold directly to customers. (Ref. Notice 10-22; issued April 2010)

19.02 Determining Suitability/ Due Diligence

In the context of a Regulation D offering, FINRA Rule 2111 (formerly NASD Rule 2310) requires broker-dealers to conduct a suitability analysis when recommending securities to both accredited and non-accredited investors that will take into account the investors' knowledge and experience. The fact that an investor meets the net worth or an income test for being an accredited investor; is only one factor to be considered in the course of a complete suitability analysis. The BD must make reasonable efforts to gather and analyze information about the customer's other holdings, financial situation and needs, tax status, investment objectives and such other information that would enable the firm to make its suitability determination. (Ref. Notice 10-22; issued April 2010)

In order to ensure that it has fulfilled its suitability responsibilities, a BD in a Regulation D offering should, at a minimum, conduct a reasonable investigation concerning:

- the issuer and its management;
- the business prospects of the issuer;
- the assets held by or to be acquired by the issuer;

- the claims being made; and
- the intended use of proceeds of the offering. (Ref. Notice 10-22; issued April 2010)

Therefore, it is the responsibility of the Firm to establish certain standards of suitability before participating in the private placement of securities. In recommending the purchase, sale, or exchange of a private securities offering, the Firm will make all reasonable efforts to ensure that, based on information provided, that:

- The customer has a significant financial position enough to realize the extent of financial benefits, to include tax benefits, as described in the prospectus;
- The customer has a sufficient net worth to sustain the potential risks of the program;
- The program is otherwise suitable for the customer;
- Documentation on the determination of suitability.

The Firm acknowledges that participation in a private offering of securities may include the use of signed subscription agreements to determine customer suitability and whether the customer meets the definition of an accredited investor. In the event that subscription agreements are not required, the Firm requires that each registered person is responsible for completing an Accredited Investor Questionnaire in place of the subscription agreement. The designated principal is responsible for ensuring the all suitability questionnaires are properly completed and that all documentation is maintained in a separate file.

Subscription or Purchase Agreements

It is the responsibility of the Firm and/or designated principal to establish certain procedures for supervision and documentation regarding the use and issuance of subscription or purchase agreements. The designated principal is responsible for ensuring that all purchasers have signed the subscription or purchase agreement as required, all agreements are complete and on file, and all agreements are retained in a separate file and clearly marked for the offering.

Disclosure Requirements

In determining the disclosure requirements of material facts, the Firm will determine whether a reasonable effort was made to disclose all material information to the customer to accurately evaluate the program. The following is a list of some of the minimum disclosure requirements as set forth in Rule 2810(b)(3)(A):

- Items of compensation;
- Physical properties;
- Tax aspects;
- Financial stability and experience of the sponsor;
- The offerings conflicts and risk factors;
- Appraisals and other pertinent reports.

In conjunction with the aforementioned disclosure requirements, and in the event that the Firm is a participant in the private offering, the Firm may rely on a due diligence inquiry from another firm if:

- There is a reasonable belief that the inquiry was conducted with due care;
- The results of the inquiry were provided to the Firm with the approval of those conducting the inquiry; and
- The inquiring firm is not a sponsor or affiliate sponsor of the offering. ►►

Implementation Strategy

On a per-transaction basis, the designated principal will review all private placements and offerings to ensure that such transactions are conducted within compliance of suitability issues. Because the designated principal is responsible for determining the qualifications of each investor and has the responsibility of approving all private placement transactions, the designated supervisor will ensure that all of the appropriate suitability information is obtained from each customer. A review of all relevant documentation will be properly evidenced as indication of review.

Specific Issues Related to a BD's Responsibilities

The scope of a BD's investigation will necessarily depend upon a number of factors, including the BD's affiliation with the issuer, its role in the transaction, and other facts and circumstances of the offering, including whether the offerees are retail customers or more sophisticated institutional investors.

1. **BD That Is Affiliated With the Issuer-** A BD that is an affiliate of an issuer in a Regulation D offering must ensure that its affiliation does not compromise its independence as it performs its investigation. The BD must resolve any conflict of interest that could impair its ability to conduct a thorough and independent investigation. Indeed, its affiliation with the issuer typically would raise expectations by its customers, particularly some retail customers, that the BD has special expertise concerning the issuer.

2. **BD That Prepares the Private Placement Memorandum-** A BD that prepares the private placement memorandum or other offering document has a duty to investigate securities offered under Regulation D and representations made by the issuer in the private placement memorandum or other offering document. A BD 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 BD for purposes of Rule 2210, FINRA's advertising rule. Moreover, sales literature concerning a private placement that a BD distributes will generally be deemed to constitute a communication by that BD with the public, whether or not the BD assisted in its preparation

3. **The Presence of Red Flags-** In the course of a reasonable investigation, a BD must note any information that it encounters that could be considered a "red flag" that would alert a prudent person to conduct further inquiry. Red flags might arise from information that is publicly available or information that is discovered during the course of the investigation. A BD's reasonable investigation responsibilities would obligate it to follow up on any red flags that it encounters during its inquiry as well as to investigate any substantial adverse information about the issuer. An issuer's refusal to provide a broker-dealer with information that is necessary for the broker-dealer to meet its duty to investigate could itself constitute a red flag. If an issuer is not forthcoming with information requested by a broker-dealer (or provides information that is non-responsive or out-of-date), the broker-dealer must determine whether sufficient information is otherwise obtainable.

4. **Reliance on Counsel and Syndicate Managers-**BD may retain counsel or other experts to assist the firm in undertaking and fulfilling its reasonable investigation obligation. A BD must carefully review the qualifications and competency of counsel or experts retained to perform an investigation on its behalf and must ensure that all gaps or omissions in the investigation by such counsel or experts are separately addressed by the BD.

    It may be appropriate in a Regulation D offering in which a BD is merely a member of a syndicate or selling group to rely upon a reasonable investigation by the syndicate manager, provided the BD has reason to believe that the syndicate manager has the expertise and absence of conflicts to engage in a thorough and independent inquiry, and that it has in fact performed such an inquiry with respect to the particular Regulation D offering. Any BD who intends to rely upon the efforts of a syndicate manager should meet with the manager, obtain a description of the manager's reasonable investigation efforts, and ask questions of the manager concerning the independence and thoroughness of the manager's exercise of its responsibilities. A BD that relies upon the efforts of the syndicate manager retains its own responsibilities, to the extent that they are not addressed by the syndicate manager's efforts. For example, if there is reason to believe that the syndicate manager has not addressed a particular issue, then each BD participating in the offering will be responsible to the extent that it implicates the BD's own suitability analysis.

Reasonable Investigation Practices

The Firm will conduct a reasonable investigation that is tailored to each Regulation D offering in a manner that best ensures that it meets its regulatory responsibilities. The following is a list of some of the areas of focus that may be considered by the Firm during the course of its investigations.

Issuer and Management

Reasonable investigations of the issuer and its management concerning the issuer's history and management's background and qualifications to conduct the business might include:

- Examining the issuer's governing documents, including any charter, bylaws and partnership agreement, noting particularly the amount of its authorized stock and any restriction on its activities. If the issuer is a corporation, a BD might determine whether it has perpetual existence.

- Examining historical financial statements of the issuer and its affiliates, with particular focus, if available, on financial statements that have been audited by an independent certified public accountant and auditor letters to management.

- Looking for any trends indicated by the financial statements.

- Inquiring about the business of affiliates of the issuer and the extent to which any cash needs or other expectations for the affiliate might affect the business prospects of the issuer.

- Inquiring about internal audit controls of the issuer.

- Contacting customers and suppliers regarding their dealing with the issuer.

- Reviewing the issuer's contracts, leases, mortgages, financing arrangements, contractual arrangements between the issuer and its management, employment agreements and stock option plans

- Inquiring about past securities offerings by the issuer and the degree of their success while keeping in mind that simply because a certain product or sponsor historically met obligations to investors, there are no guarantees that it will continue to do so, particularly if the issuer has been dependent on continuously raising new capital. This inquiry could be especially important for any blind pool or blank-check offering.

- Inquiring about pending litigation of the issuer or its affiliates.

- Inquiring about previous or potential regulatory or disciplinary problems of the issuer. A BD might make a credit check of the issuer.

- Making reasonable inquiries concerning the issuer's management. A BD might inquire about such issues as the expertise of management for the issuer's business and the extent to which management has changed or is expected to change. For example, a BD might inquire about any regulatory or disciplinary history on the part of management and any loans or other transactions between the issuer or its affiliates and members of management that might be inappropriate or might otherwise affect the issuer's business.

- Inquiring about the forms and amount of management compensation, who determines the compensation and the extent to which the forms of compensation could present serious conflicts of interest. A BD might make similar inquiries concerning the qualifications and integrity of any board of directors or similar body of the issuer.

- Inquiring about the length of time that the issuer has been in business and whether the focus of its business is expected to change

Issuer's Business Prospects

Reasonable investigations of the issuer's business prospects, and the relationship of those prospects to the proposed price of the securities being offered, might include:

- Inquiring about the viability of any patent or other intellectual property rights held by the issuer.

- Inquiring about the industry in which the issuer conducts its business, the prospects for that industry, any existing or potential regulatory restrictions on that business and the competitive position of the issuer.

- Requesting any business plan, business model or other description of the business intentions of the issuer and its management and their expectations for the business, and analyzing management's assumptions upon which any business forecast is based. A BD might test models with information from representative assets to validate projected returns, break-even points and similar information provided to investors

- Requesting financial models used to generate projections or targeted returns.

- Maintaining in the BD's files a summary of the analysis that was performed on financial models provided by the issuer that detail the results of any stress tests performed on the issuer's assumptions and projections.

Issuer's Assets

Reasonable investigations of the quality of the assets and facilities of the issuer might include:

- Visiting and inspecting a sample of the issuer's assets and facilities to determine whether the value of assets reflected in the financial statements is reasonable and that management's assertions concerning the condition of the issuer's physical plants and the adequacy of its equipment are accurate.

- Carefully examining any geological, land use, engineering or other reports by third-party experts that may raise red flags.

- Obtaining, with respect to energy development and exploration programs, expert opinions from engineers, geologists and others are necessary as a basis for determining the suitability of the investment prior to recommending the security to investors

Due Diligence

As part of the Firm's reasonable investigation practices as referenced above, the Firm will also conduct appropriate due diligence regarding private placement offerings. Prior to participating in a private offering, the Firm and any person associated with it shall have reasonable grounds to believe, based on information provided by the issuer, that all material facts are adequately and accurately disclosed in the offering memorandum and provide a basis for evaluating the offering. ►►

Implementation Strategy

The designated principal will:

- Make an initial determination as to whether or not a particular product is worthy of further consideration and whether it warrants a place on the firm's platform, if approved, i.e., that it may be suitable for someone. A particular focus during this initial step will involve an evaluation of risks, potential rewards and conflicts of interest.
- Initial evaluation of deal drivers is crucial; for example, how might rising interest rates or dramatic changes in the price of oil and gas affect a particular investment's prospects and outcome. Does the particular investment under consideration have a "reasonable" chance of meeting its objectives and/or reaching a successful outcome? Are any inherent conflicts of interest adequately addressed and resolvable?
- Review prospectus/offering memorandum, paying particular attention to use of proceeds, fees, deal terms and sharing arrangements, profit participation, etc., for fairness; where financial forecasts are included, assess reasonableness of attendant assumptions
- Selectively obtain third party DD reports; third party DD reports (see current utilization list below) are ancillary documents used in connection with execution of the firm's internal DD requirements. They are not a substitute for the firm's internal DD requirements but are used to augment the firm's responsibilities in those areas best served by a third party, e.g., principal background checks, disclosure/disposition of regulatory issues, if any, review of sponsor and deal-related organizational documents, verification of escrow/title/leasehold/insurance coverage/encumbrance documentation, tax issues, prior performance and adequacy of legally-required disclosures
- Third party DD providers will be subjected to the same level of initial and ongoing scrutiny as offering sponsors in order to ascertain their general capabilities, staffing levels and specific competencies.
- Obtain and review audited financial statements, where available; ensure the auditors are credible
- Obtain and review other third party independent reports, where applicable, including such items as real estate appraisals, property condition reports, geology, engineering and/or leasehold valuation reports; other independent reports in instances where valuations are essential, e.g., repriced follow-on offerings; assess credibility of underlying report providers
- Arrange site visit if vetting a new sponsor and/or meet face-to-face with principals; because of heightened uncertainty and attendant risk in onboarding a new sponsor, extra care and diligence will be taken in order to establish a high level of comfort with respect to a new sponsor's

reputation, prior experience, background, etc., before seriously entertaining new product offerings

- Where appropriate and/or where deemed necessary, obtain list of other BDs in the selling group and confer therewith
- Make an assessment as to whether the stated suitability guidelines are sufficient and determine whether ancillary acknowledgments are warranted for the purpose of enhancing compliance considerations
- Ensure training availability through AI Insight; if no training is available, consider severely limiting who can sell the product based on predetermined factors
- Prepare an internal memorandum detailing the firm's DD process, what was reviewed, what material questions arose, if any, and how they were disposed of
- Conduct ongoing due diligence for purposes of continuing in-force selling agreements, through:
    - A periodic review of sponsor-filed quarterly reports and SEC filings, where applicable
    - A periodic review of third-party DD provider quarterly reports and sponsor updates
    - Participate in third-party DD provider conference calls
    - Attend industry trade group meetings and DD forums
- Third party DD providers with whom AIC has current relationships are listed below. Both sponsor and/or program-level reports are obtained from one or more providers, as deemed necessary. Third party reports are considered ancillary to and an adjunct of the firm's principal responsibility for conducting adequate internal due diligence on any program(s) with which the firm enters into a selling agreement.
    - Mick Law, P.C., LLO, Omaha, NE
    - Bowman Law Firm, LLC, McEwen, TN
    - FactRight, LLC, Minneapolis, MN
    - Snyder Kearney LLC, Columbia, MD
    - Buttonwood Investment Services, LLC, Littleton, CO
    - Miterko & Associates, Roswell, GA

All offering materials and related due diligence information shall be maintained at the home office.

19.03 FINRA Filing Requirements for Private Placements

The SEC approved new FINRA Rule 5123 to require each FINRA member firm that sells an issuer's securities in a private placement, subject to certain exemptions, to file with FINRA a copy of any private placement memorandum, term sheet or other offering document the firm used within 15 calendar days of the date of the sale, or indicate that it did not use any such offering documents. Effective December 3, 2012, firms must submit filings regarding member firm private offerings (MPOs), as required by FINRA Rule 5122 (Private Placements of Securities Issued By Members), through the Firm Gateway.

Filing Requirements
In accordance with FINRA Rule 5123, each member that sells a security in a non-public offering in reliance on an available exemption from registration under the Securities Act ("private placement") must: (i) submit to FINRA, or have submitted on its behalf by a designated member, a copy of any private placement memorandum, term sheet or other offering document, including any materially amended versions thereof, used in connection with such sale within 15 calendar days of the date of first sale; or (ii) indicate to FINRA that no such offering documents were used.

Exemptions

The following private placements are exempt from the requirements of this Rule:

(1) offerings sold by the member or person associated with the member solely to any one or more of the following:

(A) institutional accounts, as defined in Rule 4512(c);

(B) qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;

(C) qualified institutional buyers, as defined in Securities Act Rule 144A;

(D) investment companies, as defined in Section 3 of the Investment Company Act;

(E) an entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A;

(F) banks, as defined in Section 3(a)(2) of the Securities Act;

(G) employees and affiliates, as defined in Rule 5121, of the issuer;

(H) knowledgeable employees as defined in Investment Company Act Rule 3c-5;

(I) eligible contract participants, as defined in Section 3(a)(65) of the Exchange Act; and

(J) accredited investors described in Securities Act Rule 501(a)(1), (2), (3) or (7).

(2) offerings of exempted securities, as defined in Section 3(a)(12) of the Exchange Act;

(3) offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;

(4) offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act and debt securities sold by members pursuant to Section 4(2) of the Securities Act so long as the maturity does not exceed 397 days and the securities are issued in minimum denominations of $150,000 (or the equivalent thereof in another currency);

(5) offerings of subordinated loans under SEA Rule 15c3-1, Appendix D (see NTM 02-32 (June 2002));

(6) offerings of “variable contracts,” as defined in Rule 2320(b)(2);

(7) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(b)(8)(E);

(8) offerings of non-convertible debt or preferred securities that meet the transaction eligibility criteria for registering primary offerings of non-convertible securities on Forms S-3 and F-3;

(9) offerings of securities issued in conversions, stock splits and restructuring transactions that are executed by an already existing investor without the need for additional consideration or investments on the part of the investor;

(10) offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(11) of the Commodity Exchange Act;

(11) business combination transactions as defined in Securities Act Rule 165(f);

(12) offerings of registered investment companies;

(13) standardized options, as defined in Securities Act Rule 238; and

(14) offerings filed with FINRA under FINRA Rules 2310, 5110, 5121 and 5122, or exempt from filing thereunder in accordance with Rule 5110(b)(7). ►►

Implementation Strategy

Unless otherwise exempt from the filing requirement, the designated supervisory principal will review each private placement to determine whether the Firm must (i) submit to FINRA, or have submitted on its behalf by a designated member, a copy of any private placement memorandum, term sheet or other offering document, including any materially amended versions thereof, used in connection with such sale within 15 calendar days of the date of first sale; or (ii) indicate to FINRA that no such offering documents were used.

19.04 Regulation D Offerings

Under the *Securities Act of 1933*, any offer to sell securities by a corporation must either register with the SEC or meet one of the available exemptions from such registration requirements. *SEC Regulation D* provides three exemptions from the registration requirements, allowing some smaller companies to offer and sell their securities without having to register the securities with the SEC.

While companies using SEC Regulation D exemptions do not have to register their securities or adhere to certain reporting requirements with the SEC, they must file what is known as a Form D after they first sell their securities. A Form D is a brief notice that includes the names and addresses of the company's owners and stock promoters, but contains little other information about the company.

Regulation D is intended to be a basic element in limited offering exemptions consistent with the provisions of *sections 18 and 19(c) of the Act*. In those states that have adopted Regulation D, or any version of Regulation D, special attention should be directed to the applicable state laws and regulations, including those relating to registration of persons who receive remuneration in connection with the offer and sale of securities, to disqualification of issuers and other persons associated with offerings based on state administrative orders or judgments, and to requirements for filings of notices of sales.

Rule 501- Key Definitions of Terms

As used in Regulation D, the following term shall have the meaning indicated:

Definition of Accredited Investor

The federal securities laws define the term accredited investor in Rule 501 of Regulation D as:

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Investment Advisers Act of 1940; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any Rural Business Investment Company as defined in section 384A of the Consolidated Farm and Rural Development Act; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income

Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

(2) Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

(4) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds $1,000,000;

> (i) Except as provided in paragraph (a)(5)(ii) of this section, for purposes of calculating net worth under this paragraph (a)(5): (A) The person's primary residence shall not be included as an asset; (B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and (C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;
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> (ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that: (A) Such right was held by the person on July 20, 2010; (B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and (C) The person held securities of the same issuer, other than such right, on July 20, 2010

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

(7) Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in § 230.506(b)(2)(ii);

(8) Any entity in which all of the equity owners are accredited investors;

(9) Any entity, of a type not listed in paragraph (a)(1), (2), (3), (7), or (8), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;

(10) Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status. In determining whether to

designate a professional certification or designation or credential from an accredited educational institution for purposes of this paragraph (a)(10), the Commission will consider, among others, the following attributes:

(i) The certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution;

(ii) The examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;

(iii) Persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and

(iv) An indication that an individual holds the certification or designation is either made publicly available by the relevant self-regulatory organization or other industry body or is otherwise independently verifiable;

(11) Any natural person who is a “knowledgeable employee,” as defined in rule 3c-5(a)(4) under the Investment Company Act of 1940 (17 CFR 270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act;

(12) Any “family office,” as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1):

(i) With assets under management in excess of $5,000,000,

(ii) That is not formed for the specific purpose of acquiring the securities offered, and

(iii) Whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and

(13) Any “family client,” as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1)), of a family office meeting the requirements in paragraph (a)(12) of this section and whose prospective investment in the issuer is directed by such family office pursuant to paragraph (a)(12)(iii)

Rule 502- General Conditions to be Met

The following conditions shall be applicable to offers and sales made under Regulation D:

All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D. Offers and sales that are made more than six (6) months before the start of a Regulation D offering or are made more than six (6) months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six (6) month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan as defined in Rule 405 under the Act.

If the issuer offers or sells securities for which the safe harbor rule in paragraph (a) of Rule 502 is unavailable, the determination as to whether separate sales of securities are part of the same offering (i.e., are considered "integrated") depends on the particular facts and circumstances.

Generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S (See *Release No. 33-6863*).

The following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D:

- whether the sales are part of a single plan of financing;
- whether the sales involve issuance of the same class of securities;
- whether the sales have been made at or about the same time;
- whether the same type of consideration is being received; and
- whether the sales are made for the same general purpose.

When Information must be Furnished

If the issuer sells securities under Rule 506 to any purchaser that is not an accredited investor, the issuer shall furnish the information specified in paragraph (b)(2) of this section to such purchaser a reasonable time prior to sale. The issuer is not required to furnish the specified information to purchasers when it sells securities under Rule 504, or to any accredited investor. Moreover, when an issuer provides information to investors pursuant to paragraph (b)(1), it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws.

Type of Information to be Furnished

If the issuer is not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, at a reasonable time prior to the sale of securities, the issuer shall furnish to the purchaser, to the extent material to an understanding of the issuer, its business, and the securities being offered:

Non-Financial Statement Information

- If the issuer is eligible to use Regulation A, the same kind of information as would be required in Part II of Form 1-A. If the issuer is not eligible to use Regulation A, the same kind of information as required in Part I of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use:

Financial Statement Information

- *For offerings up to $2,000,000*, the required information shall be in Item 310 of Regulation S-B, except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited;

- *For offerings up to $7,500,000*, the required financial statement information shall be in Form SB-2. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant;

- *For offerings over $7,500,000, t*he required financial statement information shall be in a registration statement filed under the Act on the form that the issuer would be entitled to use. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant;

If the issuer is a foreign private issuer eligible to use Form 20-F, the issuer shall disclose the same kind of information required to be included in a registration statement filed under the Act on the form that the issuer would be entitled to use.

If the issuer is subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, at a reasonable time prior to the sale of securities, the issuer shall furnish to the purchaser the information

- The issuer's annual report to shareholders for the most recent fiscal year, if such annual report meets the requirements of Rule14a-3 or Rule14c-3, the definitive proxy statement filed in connection with that annual report, and, if requested by the purchaser in writing, a copy of the issuer's most recent Form 10-K and 10-KSB;

- The information contained in an annual report on Form 10-K or 10-KSB or in a registration statement on Form S-1, SB-1 , SB-2 or S-11 or on Form 10 or Form 10-SB , whichever filing is the most recent required to be filed;

- The information contained in any reports or documents required to be filed by the issuer under sections *13(a), 14(a), 14(c), and 15(d) of the Exchange Act* and a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuer's affairs that are not disclosed in the documents furnished;

- If the issuer is a foreign private issuer, the issuer may provide the information contained in its most recent filing on Form 20-F or Form F-1.

Exhibits required to be filed with the SEC as part of a registration statement or report, other than an annual report to shareholders or parts of that report incorporated in a Form 10-K and Form 10-KSB report, need not be furnished to each purchaser that is not an accredited investor if the contents of materials are identified and made available to a purchaser, upon his written request, a reasonable time prior to his purchase.

At a reasonable time prior to the sale of securities to any purchaser that is not an accredited investor in a transaction under Rule 506, the issuer shall furnish to the purchaser a brief description in writing of any material written information concerning the offering that has been provided by the issuer to any accredited investor but not previously delivered to such unaccredited purchaser. The issuer shall furnish any portion or all of this information to the purchaser, upon his written request a reasonable time prior to his purchase.

The issuer shall also make available to each purchaser at a reasonable time prior to his purchase of securities in a transaction under Rule 506 the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information which the issuer possesses or can acquire without unreasonable effort or expense that is necessary to verify the accuracy of information furnished under Rule 502.

For business combinations or exchange offers, in addition to information required by Form S-4, the issuer shall provide to each purchaser at the time the plan is submitted to security holders, or, with an exchange, during the course of the transaction and prior to sale, written information about any terms or arrangements of the proposed transactions that are materially different from those for all other security holders.

At a reasonable time prior to the sale of securities to any purchaser that is not an accredited investor in a transaction under Rule 506, the issuer shall advise the purchaser of the limitations on resale.

Limitations on Resale

Except as provided in Rule 504(b)(1), securities acquired in a transaction under Regulation D shall have the status of securities acquired in a transaction under section 4(2) of the Act and cannot be resold without registration under the Act or the appropriate exemption. The issuer shall exercise reasonable care to assure that the purchasers of the securities are not underwriters within the meaning of section 2(11) of the Act, which reasonable care may be demonstrated by the following:

- Reasonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons;
- Written disclosure to each purchaser prior to sale that the securities have not been registered under the Act and, therefore, cannot be resold unless they are registered under the Act or unless an exemption from registration is available; and;
- Placement of a legend on the certificate or other document that evidences the securities stating that the securities have not been registered under the Act and setting forth or referring to the restrictions on transferability and sale of the securities.

Limitations on Solicitation and Advertising

Except as provided in Rule 504(b)(1), neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following:

- Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and;
- Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising;

Rule 503- Filing of Notice of Sales

The following are the notice and filing requirements for Reg D offerings. The Firm’s designated principals are required to ensure that all of the proper filings are made for each Reg D offering:

1. An issuer offering or selling securities in reliance on Rule 504 or Rule 506 shall file with the SEC five (5) copies of a notice on Form D (*17 CFR 239.500*) no later than 15 days after the first sale of securities;

2. One copy of every notice on Form D shall be manually signed by a person duly authorized by the issuer;

3. Amendments to notices filed under paragraph (a) of this Rule 503 need only report the issuer's name and the information and any material change in the facts;

4. A notice on Form D shall be considered filed with the SEC under Rule 503 as of the date on which it is received at the SEC's principal office in Washington, D.C.; or as of the date on which the notice is mailed by means of U.S. registered or certified mail to the SEC's principal office in Washington, D.C., if the notice is delivered to such office after the date on which it is required to be filed. ►►

Implementation Strategy

The designated principal will review all Reg. D (Rule 503) transactions to ensure that all required filings are made for each Rule 503 offering.

Rule 504- Exemptions for Limited Offers and Sales of Securities Not Exceeding $1,000,000

Offers and sales of securities that satisfy the conditions in Rule 504 by an issuer that is not:

- subject to the reporting requirements of *section 13 or 15(d) of the Exchange Act*;
- an investment company; or
- a development stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person, shall be exempt from the provisions of *section 5 of the Act under section 3(b) of the Act.*

General Conditions

The aggregate offering price for an offering of securities under Rule 504, as defined in Rule 501(c), shall not exceed $1,000,000, less the aggregate offering price for all securities sold within the twelve (12) months before the offering of securities under this Rule in reliance on any exemption under section 3(b), or in violation of section 5(a) of the Securities Act.

To qualify for exemption under this Rule 504, offers and sales must satisfy the terms and conditions of Rule 501 and Rule 502(a), (c) and (d), except that the provisions of Rule 502(c) and (d) will not apply to offers and sales of securities under this Rule 504 that are made:

- Exclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale, and are made in accordance with those state provisions;
- In one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for such registration, public filing and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or
- Exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to "accredited investors" as defined in Rule 501(a).

Although there may be no specific disclosure delivery requirements for this type of sale, the Firm must, however, avoid violating the antifraud provisions of the securities laws when engaging in this activity. As such, the Firm will ensure that any information provided to investors must be free from false or misleading statements or information. ►►

Implementation Strategy

The designated principal will review all Reg. D (Rule 504) transaction information to ensure that all required filings are made for each Rule 504 offering.

General Conditions

To qualify for exemption under this section, offers and sales must satisfy the terms and conditions of Rule 501 and Rule 502.

Specific Conditions

- The aggregate offering price for an offering of securities under Rule 505 shall not exceed $5,000,000, less the aggregate offering price for all securities sold within the twelve (12) months before the start of the offering of securities under Rule 505;
- The issuer reasonably believes that there are no more than 35 purchasers of securities from the issuer in any offering under Rule 505;
- No exemption under this section shall be available for the securities of any issuer described in Regulation A, except under certain circumstances.

Under this exemption, the company may sell to an unlimited number of "accredited investors" and up to 35 other persons who need not satisfy the sophistication or wealth standards associated with other exemptions. Purchasers must buy for investment only, not for resale, as the issued securities are restricted. Consequently, a company must inform investors that they may not sell for at least a year without registering the transaction. The company may not use general solicitation or advertising to sell the securities.

As long as it does not violate the antifraud provisions, the company may decide what information to give accredited investors. However, the company must give non-accredited investors disclosure documents that generally are the same as those used in registered offerings. If it provides information to accredited investors, it must make this information available to the non-accredited investors as well. The company must also be available to answer questions by prospective purchasers. ►►

Implementation Strategy

The designated principal will review all Reg. D (Rule 505) transaction information to ensure that all required filings are made for each Rule 505 offering.

Rule 506 Exemption for Limited Offers and Sales without Regard to Amount of Offering

Rule 506 is a "safe harbor" for the private offering exemption. The company can be assured that it satisfies the Section 4(2) exemption if it satisfies the following standards:

- The company can raise an unlimited amount of capital;
- The company cannot use general solicitation or advertising to market the securities;
- The company can sell securities to an unlimited number of accredited investors (see Rule 505) and up to 35 other purchasers. Unlike Rule 505, all non-accredited investors, either

alone or with a purchaser representative, must be sophisticated; they must have sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment;

- The company may decide what information to give accredited investors, as long as it does not violate the antifraud prohibitions. However, it must give non-accredited investors disclosure documents that generally are the same as those used in registered offerings. If it provides information to accredited investors, it must make this information available to the non-accredited investors as well;
- The company must be available to answer questions by prospective purchasers;
- Financial statement requirements are the same as for Rule 505; and
- Purchasers receive restricted securities. Consequently, purchasers may not freely trade the securities in the secondary market after the offering. ►►

Implementation Strategy

The designated principal will review all Reg. D (Rule 506) transaction information to ensure that all required filings are made for each Rule 506 offering

Note: In the event that a registration and/or other regulatory filing is made pursuant to "Blue Sky" laws, the Firm will also submit a copy of each filing to FINRA.

Notification Filing to FINRA

In the event that the Firm is involved in private placement offerings, the Firm will also send a copy of the offering to FINRA offices for notification purposes.

19.05 Accredited Investor Exemption - Section 4(6)

Section 4(6) of the Securities Act exempts from registration offers and sales of securities to accredited investors when the total offering price is less than $5,000,000. The definition of accredited investors is similar to that used in Regulation D. This exemption does not permit any form of advertising or public solicitation and there are no document delivery requirements. All transactions are subject to the antifraud provisions of the securities laws. The designated principal for Regulation D offerings is also responsible for ensuring that all offerings are in compliance with all applicable rules and regulations. ►►

Implementation Strategy

The designated principal will review all Section 4(6) transaction information to ensure that all required filings are made for each offering are as required in accordance with the Rule.

19.06 Regulation A Offerings

Section 3(b) of the Securities Act authorizes the SEC to exempt from registration small securities offerings. By this authority, the SEC created Regulation A, an exemption for public offerings not exceeding $5 million in any 12-month period. If it chooses to rely on this exemption, the company must file with the SEC an offering statement consisting of a notification, offering circular, and exhibits.

Regulation A offerings share many characteristics with registered offerings. For example, a company must provide a purchaser with an offering circular that is similar in content to a prospectus. Like registered offerings, the securities can be offered publicly and are not restricted, meaning they can be traded freely in the secondary market after the offering.

In comparison to that of a full registration process, some of the advantages of Regulation A offerings are as follows:

- Financial statements are often simpler and do not require auditing of such books and records;
- There are no Exchange Act reporting obligations after the offering unless the company has more than $10 million in total assets and more than 500 shareholders;
- Companies may choose among three formats for the offering circular, one of which is a simplified question-and-answer document; and
- A company may "test the waters" to determine if adequate interest in its securities exists before going through the expense of filing with the SEC.

All types of companies which do not report under the Exchange Act may use Regulation A, except "blank check" companies (those with an unspecified business) and investment companies registered or required to be registered under the Investment Company Act of 1940. In most cases, shareholders may use Regulation A to resell up to $1.5 million of securities.

If it "tests the waters," a company can use general solicitation and advertising before filing an offering statement with the SEC. By doing so, the company can gauge market interest before incurring the full range of legal, accounting, and other costs associated with filing an offering statement. The company may not, however, solicit or accept money until the SEC staff completes its review of the filed offering statement and the company delivers prescribed offering materials to investors.

The designated principal shall be responsible to review and ensure that the firm is qualified to conduct such an offering under Regulation A. Furthermore, the principal must ensure that the offering does not exceed the $5 million dollar limit in any twelve-month period. This includes the integration of previous or future offerings, which are related to the current offering.

To ensure that there are no integration requirements, the designated principal should review financial statements of the issuer for the last twelve months. The designated principal should document this review and obtain a letter from the issuer stating that no other offering has been distributed or will be distributed that would cause the exemption to be lost.

The designated principal shall be responsible for notifying the registered representatives as to when the registration statement is qualified and sales are permitted. A written record of this should be kept detailing the date and time of notification, method of notification and list of personnel notified. ►►

Implementation Strategy

The designated principal will review all Reg. A transaction information to ensure that all required filings are made for each Reg. A offering

19.07 Regulation S Offerings

Regulation S is a safe harbor from registration requirements in the United States for the offer and sale of securities to investors outside the United States. *The designated principal should take notice that a Regulation S underwriting can be extremely complex and extensive in nature*. As a result, the designated principal has an obligation to ensure that the firm completely reviews all applicable laws, rules and regulation, both foreign and domestic, as they apply to Regulation S.

Note: The following information is intended to be an overview for the designated principal; further research and review is required for each specific underwriting as warranted.

Prior to conducting Regulation S offering, the designated principal shall ensure that such an exemption applies to the underwriting. The designated principal shall review potential investors in the Regulation S underwriting to ensure that none of the purchasers are U.S. Citizens or U.S. companies. Furthermore, the principal shall ensure that the securities may not be resold U.S. citizen unless certain exemptions apply.

Securities that are sold under the Regulation S exemptions are considered restricted stock under SEC Rule 144. As such, the designated principal must ensure that such securities are not resold unless such a transaction is done so under specific conditions of Regulation S. The principal must also ensure that purchasers does not engage in any hedging transaction with these securities or use promissory notes to pay for securities. ►►

Implementation Strategy

The designated principal will review all Reg. S transaction information to ensure that all required filings are made for each Reg. S offering.

19.08 Rule 144A Offerings

Rule 144A permits the private resale of securities to institutional purchasers. The designated principal is responsible for reviewing all potential purchasers to ensure that they meet the standards for a Qualified Institutional Buyers before a purchase is made. The principal is also responsible for making written notification to inform each purchaser that the transaction is being conducted under an SEC Rule 144A exemption. Such notification shall also confirm the Firm's acknowledgement and understanding that the purchaser is a Qualified Institutional Buyer as defined in the rule.

Internally the designated principal is responsible to notify traders as to which securities are being sold under SEC Rule 144A restrictions. The principal must also notify the Financial and Operations Principal (FINOP) for net capital computation purposes if the firm acquires or takes on any Rule 144A securities in its inventory.

The designated principal, will ensure that all records, including notification, offering memorandum and any other documents associated with the offering, will be maintained and preserved according to SEC Rules 17a-3 and 17a-4. ►►

Implementation Strategy

The designated principal will review all Reg. 144A transaction information to ensure that all required filings are made for each Reg. 144A offering are as required in accordance with the Rule.

19.09 Best Efforts Distribution of Securities (SEC Rule 15c2-4)

SEC Rule 15c2-4 applies to best efforts distributions of securities. The Rule details rules and regulations for distributions that are conducted on an "all-or-none" basis, and/or any other basis where payment is not made to the issuer until a predetermined event or contingency occurs. Under this rule, broker/dealers are required to take one of the following actions concerning customer funds:

(1) Promptly deposit funds received by the investor into a separate bank account, as agent or trustee for the investors; or

(2) Promptly transmit such funds to a bank escrow agent, pending the occurrence of the contingency.

The Rule is intended to protect investor funds in an offering from unlawful activities by, or to financially benefit the broker-dealer participating in the offering. The division of investor and broker/dealer funds is to ensure that the issuer will receive the full proceeds promptly upon occurrence of a predetermined contingency. Should the contingency of the offering fail to occur, the Rule protects the investor by compelling the broker/dealer to promptly reimburse all funds to investors.

As stated above, the firm may be obligated to pursue a specific course of action when customer funds are invested. The firm's minimum net capital requirement shall determine if the firm is to act as an agent/trustee or simply transmit such funds to an escrow account. A broker/dealer with a $25,000 net capital requirement has two options in dealing with investor funds, including:

(1) Act as agent or trustee for a separate bank account until the contingency occurs; or

(2) Transmit the monies to an unaffiliated bank to hold the funds in escrow for the investors until the contingency occurs.

A broker/dealer with a $5,000 net capital requirement may only receive and promptly transmit investors' checks which are made payable to an unaffiliated bank escrow agent. Under the Rule, such a broker/dealer is prohibited from holding customer funds or accepting funds made payable to the broker/dealer.

Implementation Strategy

In the event that the Firm is operating on a contingent basis, the designated principal will ensure that the Firm will promptly transmit such funds received by customers to an unaffiliated and qualified bank escrow agent, pending the occurrence of the contingency. The designated principal will ensure the Firm promptly transmits all investor checks which are made payable to the unaffiliated bank escrow agent. Under this Rule, the Firm is prohibited from holding customer funds or accepting funds made payable to the Firm.

19.10 Intrastate Offerings

The firm may choose to participate in an offering in which the issue is sold only to residences of the state in which the issuer is located. These offerings are referred to as intrastate offerings, and exemption for such offerings are provided under *Section 3(a)11* of the *Securities Act of 1933*. *Section 3(a)(11)* permits securities to be offered and/or sold only to individuals who reside and/or do business in the same state or territory as the issuer. *SEC Rule 147* addresses some of the finer points involved with an issue offered under *Section 3(a)(11).*

Issuer

The designated principal is responsible to ensure that the issuer of the offering qualifies for the exemptions offered under *Section 3(a)(11).* The principal must verify that the firm is incorporated within the state it is making the offering in and that it maintains its principal executive offices with in the state as well. Furthermore, the principal must ensure that the issuer derives 80% of its revenue and maintains 80% of its assets with in the state, and that 80% of the offering proceeds will be used in the state as well.

Purchaser

Finally, the principal must ensure that the securities offered are being sold to individuals who are domiciled in the same state as the issuer. These securities must be sold to individuals who intend to purchase for investment purposes and will not sell the securities for a period of at least nine months.

The designated principal shall evidence all reviews of the issuer and clients as it relates to Rule 147. Such documentation will be maintained and preserved according to SEC Rules 17a-3 and 17a-4. ►►

Implementation Strategy

The designated principal will review all Intrastate offerings to ensure that all required information is available for each offering as required in accordance with the Rule. The designated supervisor will ensure that the issuer is incorporated within the state it is making the offering in and that the securities are only sold to residents of that state.

19.11 Private Placements of Tenants-in-Common (TIC) Interests

When Tenants-in-Common (TICs) are offered and sold together with other arrangements, they generally would constitute investment contracts and thus securities under the federal securities laws. An investment contract includes any contract, transaction or scheme in which persons invest their money in a common enterprise, with the expectation of profits to be derived predominantly from the efforts of others. TIC interests are generally investment contracts because the tenants in common invest in an undivided fractional interest in the rental real property by pooling their assets and sharing in the risks and benefits of the enterprise, while obtaining profits derived predominantly from the efforts of others, such as through contracts concerning leasing, management and operation of the acquired property. In addition to managing the property, TIC sponsors typically structure the TIC and negotiate the sale price and the loan. The fact that investors in a particular TIC program might have authority to terminate a management contract, or even to maintain or repair the property, would not demonstrate that the TIC interest is not an investment contract.

Although Section 1031 does not apply to an exchange of investment property for "interests in a partnership," "stocks, bonds, notes," or "other securities," the federal securities law definitions of those terms do not control interpretation of the tax laws. Accordingly, the fact that TIC interests typically are investment contracts under securities laws does not inherently disqualify them as property that may be exchanged under Section 1031.

Certain states may exempt particular types of TIC transactions from the definition of "security" under state law. However, a determination that a particular transaction does not involve a security for purposes of state law is not determinative for purposes of federal securities law.

Application of FINRA Rules to TIC Exchanges

TIC interests are a type of non-conventional investment ("NCI"). In accordance with NTM 03-71, member firms that are engaged in the sale of NCIs must ensure that those products are offered and sold in a manner consistent with the member's general sales conduct obligations, as well as address any special circumstances presented by the sale of those products. Among the issues highlighted in NTM 03-71 are members' responsibilities to:

- conduct appropriate due diligence;
- perform a reasonable-basis suitability analysis;
- perform customer specific suitability analysis for recommended transactions;
- ensure that promotional materials used by the member are fair, accurate,
- and balanced
- implement appropriate internal controls; and
- provide appropriate training to registered persons involved in the sale of these products.

Suitability and Due Diligence

Before recommending a TIC exchange, member firms must have a clear understanding of the investment goals and current financial status of the investor. In many cases, a TIC interest will constitute a significant portion of an investor's total assets. Because of the favorable tax treatment, investors often elect to invest the entire proceeds from the sale of an investment property in a TIC exchange. Concentration of an investor's assets in a single asset class (or single asset), which may well result from a TIC exchange, may not otherwise be considered suitable under established and generally accepted industry standards for gauging concentration suitability. Member firms must, with respect to each customer for whom they make a recommendation, consider the risks from over-concentration against the benefits of tax deferral and the investment potential of the underlying real estate asset(s).

TIC interests are illiquid securities. Generally, the tenant-in-common form of ownership may require unanimous consent to sell a TIC interest. The subsequent sale of TIC interests may only be possible at a significant discount to the net asset value of the undivided interest in the real estate. As fees charged in connection with a TIC exchange increase, the money saved as a consequence of tax deferral will be offset. Accordingly, member firms should consider the effect of fees on each TIC exchange

TIC exchange sponsors routinely obtain legal opinions regarding whether a particular TIC's offering structure will qualify as a like-kind exchange of real property under Section 1031. Given the importance of that tax treatment, a member firm should obtain a "clean" legal opinion that a TIC "should" or "will" qualify for exchange under Section 1031. If a sponsor failed to obtain a legal opinion, or only obtained a "more likely than not" opinion, that would be a material fact. In such a case, a member, as part of its due diligence responsibilities would be required to ascertain the specific tax status risks of the TIC exchange and inform the investor of the risks involved. (Ref. NTM 05-18) ►►

Implementation Strategy

In making a suitability determination in connection with a recommendation to a customer to purchase a TIC interest, the Firm will require that its representatives obtain a specific acknowledgement pertaining to 1031 exchange transactions outlining the tax, investment and suitability risks associated with making a tax deferred exchange.
Note: Please refer to the Firm's three 1031 exchange offering acknowledgements, one of which must be completed by the customer and submitted in connection with any 1031 transaction executed by the Firm.

Because FINRA generally believes that it is not appropriate for member firms that recommend TIC transactions simply to rely on representations made by the sponsor in an offering document, the Firm will conduct a reasonable investigation to ensure that the offering document does not contain false or misleading information. Such an investigation may include but is not limited to review of the property management agreement, purchase and sale contract, lease and loan agreements and property inspection. In addition, if the offering document contains projections, the Firm should understand the basis for those projections, and the degree of likelihood that they will occur. Additionally, the Firm should determine whether any projected yields can reasonably be supported by the property operations.

Payment of Referral Fees

Real estate agents sometimes refer their customers to broker-dealers that offer TIC exchanges. Moreover, some states may require that a licensed real estate agent participate in the transfer of a TIC interest to an investor. A broker-dealer that pays a fee to the real estate agent or splits its brokerage commissions with the agent in connection with a TIC exchange may be deemed to have violated Rule 2420. This rule generally prohibits the payment of commissions and fees to entities that operate (or based on the proposed activities, would operate) as unregistered broker-dealers.

Under Section 3(a)(4)(A) of the Securities Exchange Act of 1934, a "broker" is defined as a person "engaged in the business of effecting transactions in securities for the account of others." Section 15(a) of the Exchange Act sets forth the general registration requirements for brokers and dealers. The determination of whether an entity should be registered as a broker-dealer rests with the Securities and Exchange Commission. Among the activities the SEC staff has found require registration are:

- receiving transaction-based compensation;
- participating in presentations or negotiations;
- making securities recommendations or discussing or presenting the attributes of a securities investment
- structuring securities transactions; and
- recommending lawyers, underwriters, or broker-dealers for the distribution or marketing of securities in the secondary market.

The SEC staff may deem a real estate agent's receipt of a referral fee from a broker-dealer in connection with the sale of a TIC interest to be the type of activity that would render the real estate agent an unregistered broker-dealer. Therefore, under Rule 2420, a member firm may not pay a real estate agent who is not registered as a broker-dealer for participating in the transfer of a TIC interest that is structured as a security, nor may a member firm pay such real estate agent for referring TIC business that involves securities. A member firm also may not evade Rule 2420 through indirect payments; for example, a member firm may not engage in an arrangement in which it reduces its normal commission for a TIC exchange so that the customer will pay the difference to the real estate agent for participating in the TIC exchange or for referring business to the broker-dealer. (Ref. NTM 05-18) ►►

Implementation Strategy

The designated supervisor will provide adequate supervision to ensure that the Firm and its registered representatives avoid paying referral fees or otherwise share transaction-based compensation from TIC transactions with persons that would be deemed to be unregistered broker-dealers.

Licensing, Supervision and Recordkeeping

Associated persons selling TIC interests must pass the appropriate qualification examinations. Because TICs are typically structured as direct participation programs ("DPPs"), associated persons who sell them generally must pass either the Series 7 or the Series 22 (Limited Representative- Direct Participation Program securities). In addition, most states require the Series 63 State Agent's license. Also, as with any security, a TIC interest transaction must be reviewed and endorsed by a qualified principal in accordance with the member's supervisory procedures. A qualified principal for supervising TIC interests would be either a General Securities Principal (Series 24) or a DPP principal (Series 39).(Ref. NTM 05-18) ►►

Implementation Strategy

The designated supervisor will ensure that each associated person that participates in the sale of TICs are appropriately qualified with either the Series 7 or the Series 22 license. Additionally, each supervisory principal will be appropriately registered with a Series 24 or a Series 39 *(see Personnel, Licensing and Registration- Section 1.00 herein for further details).*

Private Offering Exemption

Many TIC transactions are conducted without registration under the Securities Act of 1933 as private placements, most in reliance on Regulation D under that statute. One of the fundamental requirements of most Regulation D offerings is a prohibition on general solicitation. As a result of this prohibition, neither the issuer nor any person acting on its behalf may offer or sell securities based on general solicitation or general advertising, including communications published in any newspaper or similar media or any seminar or meeting whose attendees have been invited by any general solicitation or advertising.

A critical factor in determining whether a communication is appropriately limited, and thus not a "general solicitation," is the existence of an adequate pre-existing relationship between a member and the TIC offeree. An adequate pre-existing relationship will enable the member to evaluate the potential TIC investor's sophistication and financial circumstances.

If a communication is made by general solicitation, then an issuer or its agents will have made a prohibited general solicitation if the communication includes an offer of the privately placed securities. If the communication references a security that is currently offered or contemplated to be offered at the time of the communication, the communication will generally be considered an offer of that security. In addition, if the person solicited via the communication is subsequently offered a security that was currently offered or contemplated to be offered at the time of the communication, the communication would generally be considered an offer of that security.

In general, such an advertisement would not be deemed an offer of securities if:

- the advertisement is generic;
- the advertisement is not being made in contemplation of an offering; and
- the member has procedures to ensure that an investor solicited via the advertisement will not be offered TICs that the member firm is currently offering or contemplating offering at the time of the initial contact.

Advertisements that do not meet each of these conditions are likely to be deemed general solicitations and inconsistent with the conditions for private placements conducted in compliance with Regulation D. Moreover, in addition to meeting these conditions, the other requirements under Regulation D also must be met, including establishing an adequate, substantive and pre-existing relationship with the investor and completing a suitability analysis prior to offering TICs to an investor. (Ref. NTM 05-18) ►►

Implementation Strategy

The designated supervisor will review relevant sales practice issues regarding the Firm's registered representatives and/or any advertisements (if applicable) to ensure that the Firm is complying with the aforementioned requirements and criteria in accordance with Reg. Ds.

19.12 Mergers and Acquisition Services

Due Diligence (Initial Document Request List)

Firms may require the use of certain documentation checklists to facilitate the capture of client data for due diligence purposes. More specifically, the Firm will request the following documentation with respect to its mergers and/or acquisition services:

1. Articles of Incorporation (including all amendments)
2. By-Laws
3. Acquisition Agreements
4. Employment Agreements, Consulting Agreements and Confidentiality/Non-Compete Agreements with employees & contractors
5. Customer Agreements
6. Supplier Agreements
7. Licensing Agreements
8. Distribution Agreements
9. Lease Agreements for offices/facilities or other significant property
10. All other significant contracts to which the company is a party
11. Revenue contributed by each major service or product for the last two fiscal years and forecast for the current fiscal year

12. List of major customers and revenues received from each such customer for the last two fiscal years and forecast for the current fiscal year.
13. Current sales pipeline
14. Accounting records
15. Insurance declaration pages

Implementation Strategy

In the event that the Firm engages in M&A activities, the designated supervisor is responsible for completing the appropriate level of due diligence on each client to determine legitimacy of each firm as well as the accuracy of information provided. (See the Preliminary Due Diligence Information Request List and Initial Due Diligence Checklist for further details). Moreover, each client is required to complete each document which covers topics such as Company; Business; Management; Capitalization; Shareholders; Legal Matters; and Financial Statements.

NOTE: The Firm currently does not engage in M&A activities.

19.13 Fairness Opinion Services

Fairness Opinions

A fairness opinion addresses, from a financial point of view, the fairness of the consideration in a transaction. Fairness opinions are routinely used by directors of companies in connection with a change of control transaction, such as a merger or sale or purchase of assets, to satisfy their fiduciary duties to act with due care and in an informed manner. Fairness opinions assist directors in fulfilling their fiduciary obligations. Under the business judgment rule, a corporate board of directors is protected from liability to a company's shareholders for decisions made in good faith, in an informed manner and on a rational basis. A number of courts have held that directors can fulfill their fiduciary duty of care by relying in good faith on fairness opinions. Fairness opinions typically provide that the opinion is for the use and benefit of the board of directors, but the opinions are disclosed in various SEC forms and investors often refer to them.

In addition to providing a basis for the exercise of care by the board of directors, a fairness opinion, or information about a fairness opinion, is often provided to shareholders as a part of the proxy materials relating to a change of control transaction. Fairness opinions express a conclusion as to the whether the consideration offered in a transaction is within the range of what would be considered "fair"; such opinions generally do not offer an opinion as to whether the consideration offered is the best price that could likely be attained or reach other matters, such as solvency issues, that may arise from the transaction.

Under the SEC's proxy rules, which apply to issuers, certain disclosures about potential conflicts of interest are provided to investor-shareholders. Rule 2290 is a complementary rule that requires broker-dealers that render fairness opinions to inform investor-shareholders about the potential conflicts of interest that may exist between the firm rendering the fairness opinion and the issuer. The Rule also addresses specific procedures concerning the issuance of fairness opinions.

If a member firm knows or has reason to know, at the time a fairness opinion is issued to a company's board, that the opinion will be provided or described to the company's public shareholders, the firm must make the enumerated disclosures in the fairness opinion. A firm will be deemed to have a reason to know that the fairness opinion will be provided or described to public shareholders, if, for example, the structure of the transaction will require a shareholder vote. The fairness opinions covered by the Rule include those issued to the board of directors, and/or any special committee or other subset or committee of the board.

Acting as Financial Advisor and Contingent Compensation

A firm is required to disclose if the firm has acted as a financial advisor to any party to the transaction that is the subject of the fairness opinion, and, if applicable, that it will receive compensation that is contingent upon the successful completion of the transaction, for rendering the fairness opinion and/or serving as an advisor. This requirement includes significant payments or compensation from related transactions (*e.g.*, stapled financings) if such transactions are contingent upon the completion of the transaction for which the fairness opinion was issued.

Other Significant Payment or Compensation

A firm must disclose if it will receive any other significant payment or compensation contingent upon the successful completion of the transaction.

Material Relationships

A firm is required to disclose any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between the firm and any party to the transaction that is the subject of the fairness opinion. This disclosure requirement includes any material relationships between the member firm and all parties to the transaction, not just the party whose board of directors selected the member firm to render the fairness opinion; *e.g.*, in the case of a takeover, a member issuing a fairness opinion to the target's board of directors would also have to disclose any material relationships it had with the acquirer.

Independent Verification of Information

A firm is required to disclose if any information that formed a substantial basis for the fairness opinion that was supplied to the firm by the company requesting the opinion concerning the companies that are parties to the transaction has been independently verified by the firm, and if so, a description of the information or categories of information that were verified. When no information has been verified, a blanket statement to that effect is sufficient. On the other hand, if a member firm independently verifies some or all of the information supplied to it concerning the companies that are parties to the transaction, it must describe the information or the categories of information that were verified.

Use of Fairness Committee

A disclosure of whether or not the fairness opinion was approved or issued by a fairness committee is required.

Compensation to Insiders

Firms are also required to disclose whether or not the fairness opinion expresses an opinion about the fairness of the amount or nature of the compensation to any of the company's officers, directors or employees, or class of such persons, relative to the compensation to the public shareholders of the company. This disclosure highlights to the investor the potential conflict of interest between the member issuing the fairness opinion and the issuer receiving the opinion by requiring disclosure of whether the member did or did not take into account the amount and nature of compensation flowing to certain insiders relative to the benefits to shareholders in reaching a fairness determination.

In accordance with Rule 2290(a), the firm must have procedures regarding the types of transactions and the circumstances in which the firm will use a fairness committee to approve or issue a fairness opinion, and in those transactions in which it uses a fairness committee:

- the process for selecting personnel to be on the fairness committee;

- the necessary qualifications of persons serving on the fairness committee; and the process to promote a balanced review by the fairness committee, which shall include the review and approval by persons who do not serve on the deal team to the transaction. (Ref. Regulatory Notice 07-54; Effective Date December 8, 2008) ►►

Implementation Strategy

In the event that the Firm engages in Fairness Opinions, the designated supervisor will ensure that the Firm is properly disclosing its involvement in any of the following:

- Acting as Financial Advisor and Contingent Compensation;
- Other Significant Payment or Compensation;
- Material Relationships;
- Independent Verification of Information;
- Use of Fairness Committee; and/or
- Compensation to Insiders.

Regarding the use of fairness committees, the Firm will document the selection and qualification process for any person serving on the fairness committee. Additionally, the Firm will document its process to promote a balanced review by the fairness committee, which shall include the review and approval by persons who do not serve on the deal team to the transaction.

NOTE: The Firm currently does not directly engage in the types of business activities requiring the generation or use of Fairness Opinions.

19.14 Public Investment in Private Equity (PIPEs)

PIPE transactions are privately issued equity or equity-linked securities that are sold to accredited investors under Regulation D by public companies. PIPE issuers range in size from small OTC Bulletin Board companies to large-cap NYSE-traded companies. Transaction sizes have ranged from under $1 million to over $200 million.

Within the spectrum of equity alternatives for a publicly traded company, a PIPE transaction generally best fits companies with a market capitalization under $400 million that seek an equity infusion of less than $75 million. Traditional public equity alternatives include add-on equity offerings ("secondary" or follow-on offerings) and 144A convertible securities. These transactions are typically underwritten and require extensive institutional and/or retail distribution networks. Due to the need for liquidity in the secondary trading market for these types of securities, as well as the overhead requirement on the part of the underwriter, the minimum transaction size can range from $65 million to $100 million to achieve optimal execution for traditional public offerings.

While a PIPE transaction is marketed to a limited number of investors over a short period of time, a traditional public transaction may require a broader marketing process and, in the case of an add-on offering, the filing of a registration statement with the SEC prior to pricing. This filing process tends to create an overhang in the market, resulting in an "announcement effect" on the issuer's stock. This announcement effect has been studied, and most practitioners use a proxy of a 15% decline in the stock price prior to pricing. For companies that are able to access traditional public alternatives for larger amounts (typically above $75 million), pricing at the close of the transaction may be more issuer-friendly than a PIPE transaction due to broader marketing and the lack of any liquidity discount associated with receiving unregistered securities. However, careful review of the entire process must be conducted to determine the full array of strengths and weaknesses associated with each alternative.

ISSUER CONSIDERATIONS

Following are the benefits a potential issuer may consider when evaluating a PIPE transaction:

- Does not require SEC registration prior to offering
- Allows for a more flexible transaction size than traditional public alternatives
- Improves balance sheet strength and financial flexibility
- Offers greater confidentiality and eliminates typical price declines on filing of traditional public offering (“announcement effect”)
- Requires minimal preparation before launch
- Increases issuer’s trading liquidity levels and diversifies shareholder base
- Allows for a targeted marketing process, reducing management’s time contribution

PIPE TRANSACTION TYPES

PIPE transactions may be issued in a variety of forms, including registered common stock (“registered directs”), unregistered common stock, convertible preferred stock, convertible debt and equity credit lines (“ECLs”).

Registered Direct Common Stock	Common stock issued under an existing and effective registration statement. Essentially a traditional add-on offering marketed to, and negotiated with, a select investor universe vs. broad marketing from an institutional and retail sales force. This security offers the investor the benefits of receiving registered shares. Issuers have the benefit of mitigating a liquidity discount and broadening the investor base.
Common Stock	Common stock issued as a private placement under Regulation D with an agreement to register the shares as soon as possible after the transaction closes. Provides investors with the ability to build a position in a security and enables the issuer to quickly and quietly access the equity market. A liquidity discount is typically incorporated into the pricing due to the fact that the investor is unable to trade the shares until they are registered.
Convertible Preferred or Convertible Debt	Equity-linked security structured as preferred stock or subordinated debt. The security is issued as a private placement with an agreement to register the underlying shares as soon as possible after the transaction closes. Provides an investor with a senior position relative to the common shareholders as well as current income in the form of a dividend or coupon. Provides an issuer with broad flexibility with regard to structure and the ability to issue stock at a premium to a straight common stock alternative. Issuers should understand that convertible transactions tend to cause “overhang” in the market, i.e., the downward pressure on stock prices due to the existence of a sizeable block of securities that will be released into the market. Depending on the structure, consideration should also be given to rating agency treatment and senior debt covenants, if applicable.
Equity Credit Line	A contractual agreement between an issuer and investor that enables the investor to purchase a formula-based quantity of

	stock at set intervals of time, typically monthly, at future stock prices. Formulas tend to be based on trading liquidity. An effective registration statement must be maintained in order for drawdowns to be completed.

Implementation Strategy

In the event that the Firm engages in PIPE transactions, the focus will be on common stock PIPEs in accordance with Reg. D as referenced above. For example, in the event the Firm engages in a common stock PIPE, the designated principal will review all relevant PIPE documentation to ensure that the common stock is issued as a private placement under Regulation D with an agreement to register the shares as soon as possible after the transaction closes. Additionally, the designated principal will review supporting documentation regarding any liquidity discount that may be incorporated into the pricing due to the fact that investors will be unable to trade the shares until they are registered. The designated supervisor will ensure that all relevant PIPE documentation is properly reviewed, evidenced and maintained in accordance with books and records requirements.

NOTE: The Firm currently does not directly engage in PIPE transactions.

19.14 Member Private Offerings

The Firm is not in the business of conducting advisory side mergers and acquisition services. While on occasion the Firm may participate in private offerings of securities, the Firm does not anticipate engaging in a private offering in which the Firm or an affiliate is the issuer.

The following is provided for information purposes only. In instances where the Firm or its associated persons offer, in a private placement, unregistered securities through the Firm or an entity that controls, is controlled by, or is under common control with the Firm, the CCO must ensure full compliance with FINRA Rule 5122. Generally, Rule 5122 requires the following:

- Disclosure to investors (whether or not accredited) of the intended use of offering proceeds and the offering expenses. Such disclosures may be provided in a private placement memorandum, term sheet or other offering document.
- Filing such disclosures and/ or offering documents with FINRA's Corporate Financing Department at or before it is provided to any investor (and file amendments or exhibits later provided to investors, within 10 days of providing them).
- Commitment to use at least 85 percent of the offering proceeds for business purposes, which do not include offering costs, discounts, commissions and any other cash or non-cash sales incentives. Such commitment is typically reflected in the offering document(s) provided to investors.

For purposes of this Rule, control is defined as a beneficial interest, as defined in Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity. Control is determined immediately after the closing of an offering, and in the case of an offering with multiple intended closings, immediately following each closing.

This Rule applies only to the Firm *when it sells its own securities* or those *issued by a control entity* as defined in the Rule and does not apply to offerings in unaffiliated issuers.

Member Private Offering Exemptions under FINRA Rule 5122

Member Private Offerings ("MPOs") sold solely to institutional accounts, qualified purchasers, qualified institutional buyers (and an entity composed of such), investment companies, and banks are exempt from the Rule. The designated RP should review with the CCO this Rule in its entirety for definitions of these investor types prior to assuming any exemption.

MPOs that are: unregistered investment-grade debt and preferred securities; offerings to employees and affiliates of the issuer or its control entities; and/or offerings of securities issued in conversions, stock splits and restructuring transactions made to existing investors are also exempt, so long as there are no additional considerations or investments made on the part of the investor. Other MPOs which are exempt include:

- Offerings of exempted securities, as defined by Section 3(a)(12) of the Exchange Act (such as government and municipal securities, among others);
- Offerings made pursuant to Securities Act Rule 144A or SEC Regulation S (resale of restricted securities and sales of unregistered securities outside the U.S.);
- Offerings in which the Firm acts primarily in a wholesaling capacity (*i.e.,* it intends, as evidenced by a selling agreement, to sell through its affiliate broker-dealers, less than 20 percent of the securities in the offering);
- Offerings of exempted securities with short term maturities under Section 3(a)(3) of the Securities Act;
- Offerings of subordinated loans under the Exchange Act Rule 15c3-1, Appendix D10;
- Offerings of "variable contracts," as defined in Consolidated FINRA Rule 2320(b)(2);
- Offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referred to in Consolidated FINRA Rule 5110(b)(8)(E);
- Offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(5) of the Commodity Exchange Act;
- Offerings of equity and credit derivatives, including OTC options, provided that the derivative is not based principally on the member or any of its control entities; and
- Offerings filed with FINRA under Rule Consolidated FINRA 5110, NASD Rule 2720 or Consolidated FINRA Rule 2310 (DPPs).

Prior to engaging in an MPO, the designated supervisor must review with the CCO the Rule its entirety to determine if the offering meets any of these exemptions. If exempt, supporting notes must be maintained by the Firm to later justify the conclusion that the MPO was indeed exempt. If not exempt, the Firm must comply with the requirements summarized above and records must be maintained in accordance with FINRA rules. Records will include as applicable, but may not be limited to: offering documents (such as a private placement memorandum, term sheet or other such document making the required disclosures); amendments and exhibits to offering documents, if any; regulatory filings; and records of control calculations and offering proceeds and expenses.

Updated Private Placement Filer Form

FINRA has updated the form that firms must use to file offering documents and information pursuant to FINRA Rules 5122 (Private Placements of Securities Issued by Members) and 5123 (Private Placements of Securities) (Filer Form). The updated Filer Form includes the following new and updated questions that will facilitate review of the filed material.

Participating Member Information

FINRA will be adding questions to the Participating Member section of the Filer Form regarding whether the member making the filing (filing member) is the exclusive selling agent in the private placement and whether there is any affiliation between the issuer or sponsor of the private placement with any member participating in the offering upon whose behalf the filing member is submitting the Filer Form. This section will no longer require the title and email address for the contact person of the filing member or the contact name, title and telephone number for other members identified in the filing.

Issuer Information

FINRA is adding a question to the Issuer Information section of the Filer Form asking whether the issuer is a reporting company. This section will no longer require the filing member to enter the name, title and email address of the issuer's contact person.

Offering Information

FINRA is adding questions to the Offering Information section of the Filer Form regarding:

- the type of security the issuer is offering;
- whether the issuer raised capital within the preceding 12 months from any source (excluding loans or investments by affiliates);
- the minimum investment amount that the issuer will accept and whether the issuer can waive that minimum;
- whether the filing member sold or will sell the offering to any non-accredited investors;
- the exemption from the Securities Act of 1933 that the issuer is relying upon; and
- for contingency offerings, whether the contingency has been met as of the date of the filing. *Ref. FINRA Regulatory Notice 17-17; April 2017*

19.15 Private Placement Retail Communications

Many private placement offerings to retail investors include marketing or sales communications that meet the definition of retail communication in Rule 2210(a)(5). FINRA has observed that more than 40 percent of the offerings filed pursuant to FINRA Rule 5123 include retail communications. In addition, the adoption of Rule 506(c) under Reg D eliminated the prohibition against general solicitation and advertising for private placement offerings where all purchasers of the securities are verified accredited investors. Consequently, member firms have become increasingly involved in the distribution of private placement securities through online platforms and other widely disseminated communications such as digital advertisements.

FINRA Rule 2210(d)(1) requires that all member firm communications be fair, balanced and not misleading. Communications that promote the potential rewards of an investment also must disclose the associated risks in a balanced manner. In addition, communications must be accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed. Rule 2210(d)(1) also prohibits false, misleading or promissory statements or claims, and prohibits the publication, circulation or distribution of a communication that a member firm knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. With few exceptions, Rule 2210(b)(1) requires that an appropriately registered principal must approve each retail communication before the earlier of its use or filing with FINRA's Advertising Regulation Department.

Recent FINRA reviews of retail communications concerning private placements have revealed deficiencies. For instance, most if not all investments in private placements are illiquid, and many such investments are speculative in nature. Some retail communications do not balance claims of these investments' benefits by disclosing these risks. Others have contained false, misleading, or promissory statements or claims such as assertions about the likelihood of a future public offering of the issuer, claims about the future success of the issuer's new or untried business model, inaccurate or misleading assertions concerning the regulation or relative risk of the offering, or predictions or projections of investment performance prohibited by FINRA Rule 2210(d)(1)(F).

FINRA is providing the following guidance to assist member firms in their creation, review, approval, distribution or use of retail communications concerning private placement securities.

Third-Party Prepared Materials

Rule 2210(a)(5) defines "retail communication" as "any written (including electronic) communication that is ***distributed or made available*** to more than 25 retail investors within any 30 calendar-day period." Member firms can be liable for violations of Rule 2210 when distributing or using noncompliant retail communications prepared by a third party.

Regulatory Notice 10-22 states 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 … Rule 2210, FINRA's advertising rule. If a private placement memorandum or other offering document presents information that is not fair and balanced or that is misleading, then the [member firm] that assisted in its preparation may be deemed to have violated … Rule 2210." *Notice 10-22* also provides that "sales literature concerning a private placement that a [member firm] distributes will generally be deemed to constitute a communication by that [member firm] with the public, whether or not the [member firm] assisted in its preparation."

FINRA has observed that some issuer-prepared private placement memoranda (PPMs) are bound or presented as one electronic file with retail communications, such as cover pages or exhibits. Such retail communications are distinguishable by their marketing or promotional content from the factual descriptions and financial information about the issuer generally disclosed in the PPMs. Regardless of whether a member firm distributes a retail communication that is attached to a PPM or as a standalone document, it constitutes a communication of the member firm subject to Rule 2210.

Balanced Presentation of Risks and Investment Benefits

Rule 2210 requires communications that discuss the benefits of an investment also to include a discussion of its risks. Retail communications that discuss the potential benefits of investing in private placements should balance this discussion with disclosure of their risks, such as the potential for private placement investments to lose value, their lack of liquidity and their speculative nature. Providing risk disclosure in a separate document, such as a PPM, or in a different section of a website does not substitute for disclosure contained in or integrated with retail communications governed by Rule 2210.

Retail communications often highlight the business of the issuer and discuss the value proposition of a potential investment. In such cases, the key risks associated with an investment in the issuer are necessary in order to balance the positive portrayal of the investment. For example, when the issuer is a startup company, the risks may include a limited track record; more experienced or larger competitors; overreliance on financing; reliance on a single supplier, customer or employee; or lack of management experience.

Reasonable Forecasts of Issuer Operating Metrics

Rule 2210(d)(1)(F) generally prohibits the use of any prediction or projection of performance, as well as any exaggerated or unwarranted claim, opinion or forecast. Accordingly, retail communications concerning private placements may not project or predict ***returns to investors*** such as yields, income, dividends, capital appreciation percentages or any other future investment performance.

However, FINRA would not consider reasonable forecasts of ***issuer operating metrics*** (*e.g.*, forecasted sales, revenues or customer acquisition numbers) that may convey important information regarding the issuer's plans and financial position to be inconsistent with the rule. Presentations of reasonable forecasts of issuer operating metrics should provide a sound basis for evaluating the facts as required by Rule 2210(d)(1)(A). For example, such presentations should include clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede the issuer's achievement of the forecasted metrics.

When creating, reviewing, approving, distributing or using forecasts of issuer operating metrics in retail communications, member firms should consider:

i. the time period forecasted (generally a time period in excess of five years would be unreasonable);
ii. whether growth rate assumptions are commensurate with the nature and scale of the business;
iii. whether forecasted gross margins[14] are commensurate with industry averages; and
iv. whether sales and customer acquisition forecasts are reasonable in relation to the overall market for the issuer's products or services.

While sources of contractual revenue such as royalty or master lease agreements may inform or provide a basis for reasonable forecasts of issuer operating metrics, it would be inconsistent with Rule 2210(d)(1)(B) to characterize specific revenue or cash flow as guaranteed or certain. Moreover, Rule 2210(d)(1)(F) precludes member firms from using the data from forecasts of issuer operating metrics to project or depict specific investment returns to an investor.

Distribution Rates

Regulatory Notice 13-18 provided guidance to member firms regarding communications with the public for registered and unregistered real estate investment programs. Given that some non-real estate private placement investments employ similar structures, the principles relating to distribution rates contained in that *Notice* are applicable to retail communications regarding private placement investments designed to provide distributions to investors and are reiterated below.

Some issuers fund a portion of their distributions through return of principal or loan proceeds. For example, a portion of a newer program's distributions might include a return of principal until its assets are generating significant cash flows from operations. Consistent with Rule 2210(d)(1)(B)'s prohibition of false, exaggerated, unwarranted, promissory or misleading claim, member firms must not misrepresent the amount or composition of such distributions. Nor may member firms state or imply that a distribution rate is a "yield" or "current yield" or that investment in the program is comparable to a fixed income investment such as a bond or note. Presentations of distribution rates consistent with Rule 2210 would disclose:

- that distribution payments are not guaranteed and may be modified at the program's discretion;
- if the distribution rate consists of return of principal (including offering proceeds) or borrowings, a breakdown of the components of the distribution rate showing what portion of the quoted percentage represents cash flows from the program's investments or operations, what portion represents return of principal, and what portion represents borrowings;
- the time period during which the distributions have been funded from return of principal (including offering proceeds), borrowings or any sources other than cash flows from investment or operations;
- if the distributions include a return of principal, that by returning principal to investors, the program will have less money to invest, which may lower its overall return; and
- if the distributions include borrowed funds, that since borrowed funds were used to pay distributions, the distribution rate may not be sustainable.

FINRA believes that it is inconsistent with Rule 2210(d)(1) for retail communications to include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive full quarterly periods.

Internal Rate of Return

Internal Rate of Return (IRR) is a measure of performance commonly used in connection with marketing private placements of real estate, private equity and venture capital. IRR shows a return earned by investors over a particular period, calculated on the basis of cash flows to and from investors (*i.e.,* the percentage rate earned on each dollar invested for each period the dollar was invested). IRR is calculated as the discount rate that makes the net present value of all cash flows from an investment equal to zero.

A drawback of IRR calculations is their inherent assumption that investors will be able to reinvest any distributions from the investment at the IRR rate. In practice, it is unlikely that this would occur. Another drawback is that in order to calculate IRR for a portfolio that includes holdings that have not yet been sold (or otherwise liquidated or matured), a valuation of those remaining assets must be estimated. Depending on the nature of the asset, these estimated values may be based on subjective factors and assumptions.

The use of IRR in retail communications concerning 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 Rule 2210(d)(1)(F).

Nevertheless, FINRA interprets Rule 2210 to permit retail communications to include IRR for completed investment programs (*e.g*., the holding matured or all holdings in the pool have been sold). In addition, FINRA does not view as inconsistent with the rule retail communications that provide an IRR for a specific investment in a portfolio if the IRR represents the actual performance of that holding.

Investment programs such as private equity funds and REITs may have a combination of realized investments and unrealized holdings in their portfolios. Where the program has ongoing operations, FINRA interprets Rule 2210 to permit the inclusion of IRR if it is calculated in a manner consistent with the Global Investment Performance Standards (GIPS) adopted by the CFA Institute and includes additional GIPS-required metrics such as paid-in capital, committed capital and distributions paid to investors. (Ref. Regulatory Notice 20-21; July 1, 2020)

Implementation Strategy

The designated supervisor will review and approve each retail communication (private placement communications) before the earlier of its use or filing with FINRA's Advertising Regulation Department, to ensure that, in accordance with FINRA Rule 2210(d)(1), communications are (i) fair, balanced and not misleading; (ii) those that promote the potential rewards of an investment also must disclose the associated risks in a balanced manner; (iii) are accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed; (iv) prohibit false, misleading or promissory statements or claims, and (v) prohibit the publication, circulation or distribution of a communication that a member firm knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

Special attention will be given to the following:

- Third-Party Prepared Materials
- Balanced Presentation of Risks and Investment Benefits
- Forecasts of Issuer Operating Metrics
- Distribution Rates
- Internal Rate of Return