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Comments to FINRA Regulatory Notice 11-04, Proposed Amendments to Rule 5122

Our comments are linked to specific subsections of the proposed rule as noted below.

Proposed Rule 5122 Section:

**(b)(1)(A)(ii):** Preliminarily, we note that references to “offering expenses” does not indicate whether FINRA is referring to only the member’s expenses or the issuer’s expenses. Presumably you are proposing to limit only member expenses, but if you are limiting the issuer’s expenses the new rule would reduce the number and scope of road shows, encourage the issuer to engage lower-quality counsel and auditors and to produce lower-quality disclosure materials in general, with a view to keeping costs down. This will be especially harmful to smaller private placements, of which there are many, as certain costs (audit, counsel, travel, Blue Sky) are relatively fixed, and do not increase or decrease significantly with the size of the offering. The rule’s impact on member firms is equally damaging to the offering process, especially with respect to smaller offerings (either as a result of market conditions or regulatory limitations). The cost of due diligence, placement agent counsel and road show expenses, do not vary with deal size. If compensation and expenses are limited to 15%, due diligence will necessarily be the first item eliminated from the budget or, in some cases, simply eliminate financing options for an issuer. This is not in the best interests of the investors in the proposed transaction or the issuers that the rule is intended to protect. The rule should be revised to make explicit that non-variable third party costs (counsel, travel, blue sky, third-party diligence) are excluded in their entirety from the calculations of “offering expenses”.

**(b)(2):** If the filing is to be made via Cobradesk, note that Cobradesk does not currently permit such filings to be made. The rule should make explicit exactly how the filings are to be made.

**(b)(3):** Again, please clarify whose offering costs must be included. Also “other compensation” can include placement agent stock purchase warrants, rights of first refusal on subsequent offerings by the issuer, or tail fees on subsequent investments by investors first introduced by a particular member firm. These are non-cash items that do not detract from your proposal that 85% of gross proceeds go to the issuer’s business. While we have no objection to a disclosure requirement of these non-cash items, we don’t understand how their existence contradicts that goal. Further, the Corporate Financing Department has no publicly disclosed formula for valuing either rights of first refusal or tail fees in the context of public offerings, so even a member firm trying to be compliant would not be able to ascertain their actual compliance with the proposed rule in the context of a particular offering. We recommend that all non-cash forms of compensation be ignored for purposes of the rule.

**(c)(1):** The classes of exempted investors are too restrictive and will end up discriminating against certain classes of active institutional investors; particularly recently organized institutional funds that are still in their fund-raising stages and do not yet have \$50,000,000 under management, but which are managed by portfolio managers every bit as sophisticated as more established funds. The standard prescribed by Rule 3310(c)(4) in a different context, is an overly restrictive standard. The typical new investment fund is started by the senior management of an existing fund. It takes an extended period to accumulate the proposed requirement of \$50,000,000 under management. In the interim, member firms will avoid presenting private placement opportunities to these younger funds in order to avoid needing to comply with Rule 5122. This will only harm investors who will be unnecessarily excluded from private placements, and issuers, whose universe of potential investors will shrink, and not the member firms. At most, the “qualified purchaser” standard of Section 2(a)(51)(A) of the Investment Company Act would be tolerable. This will still negatively impact smaller and retail offerings in the ways pointed out above with respect to Section (b)(1)(A)(ii) of the proposed Rule. All private placements limited to “accredited investors” should be exempted, particularly in light of the Dodd-Frank law’s change in the definition of accredited investor to exclude the value of an individual’s primary residence.