OMB APPROVAL	
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Page 1 of 133

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2008 - 020
Amendment No.

Proposed Rule Change by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change to adopt a new FINRA Rule 5122 to impose requirements regarding Member Private Offerings.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Stan Last Name: Macel
Title: Assistant General Counsel
E-mail: stan.macel@finra.org
Telephone: (202) 728-8056 Fax: (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date: 09/11/2008

By: Gary L. Goldsholle (Name)

Vice President and Associate General Counsel (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Gary Goldsholle,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt new FINRA Rule 5122. This proposed rule change would require a member that engages in a private placement of unregistered securities issued by the member or a control entity to (1) make certain disclosures to investors in a private placement memorandum ("PPM"), (2) file the PPM with FINRA, and (3) commit that at least 85 percent of the offering proceeds will be used for the business purposes identified in the PPM.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5120. Offerings of Members' Securities

* * * * *

[1] 15 U.S.C. 78s(b)(1).

5122. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering

A private placement of unregistered securities issued by a member or a control entity.

(2) Control Entity

Any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons. The term "control" for purposes of this Rule means beneficial interest, as defined in NASD Rule 2790(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. In the case of multiple closings, control will be determined at the first closing.

(3) Private Placement

A non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act.

(b) Requirements

No member or associated person may offer or sell any security in a Member Private Offering unless the following conditions have been met:

(1) Filing Requirements

A private placement memorandum must be filed with the Corporate Financing Department ("Department") at or prior to the first time the private placement memorandum is provided to any prospective investor. An amendment

or exhibit to the private placement memorandum also must be filed with the Department within ten days of being provided to any investor.

(2) Disclosure Requirements

A private placement memorandum must be provided to each prospective investor and the private placement memorandum must disclose:

(A) intended use of the offering proceeds; and

(B) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons.

(3) Use of Offering Proceeds

At each time a Member Private Offering is closed, at least 85 percent of the offering proceeds raised must be used for the business purpose identified in the "intended use of the offering proceeds" disclosure in the private placement memorandum.

If, in connection with the offer and sale of any security in a Member Private Offering, a member or associated person discovers after the fact that one or more of the conditions listed above have not been met, the member or associated person must promptly conform the offering to comply with this Rule.

(c) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) offerings sold solely to:

(A) institutional accounts, as defined in NASD Rule 3110(c)(4);

(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; and

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

(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 in which a member 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% of the securities in the offering);

(5) offerings of exempted securities with short term maturities under Section 3(a)(3) of the Securities Act;

(6) offerings of subordinated loans under SEA Rule 15c3-1, Appendix D;

(7) offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);

(8) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in NASD Rule 2710(b)(8)(E);

(9) offerings of unregistered investment grade rated debt and preferred securities;

(10) offerings to employees and affiliates of the issuer or its control entities;

(11) 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;

(12) offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(5) of the Commodity Exchange Act;

(13) offerings of equity and credit derivatives, including OTC options; provided that the derivative is not based principally on the member or any if its control entities; and

(14) offerings filed with the Department under NASD Rules 2710, 2720 or 2810.

(d) Confidential Treatment

FINRA shall accord confidential treatment to all documents and information filed pursuant to this Rule and shall utilize such documents and information solely for the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

(e) Application for Exemption

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on July 20, 2006, the Board of Governors of FINRA (then known as NASD) authorized the filing of the rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change. FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

Background and Discussion

FINRA is proposing new FINRA Rule 5122 in response to problems identified in connection with private placements by members of their own securities or those of a control entity (referred to as "Member Private Offerings" or "MPOs"). In recent years, FINRA has investigated and brought numerous enforcement cases concerning abuses in connection with MPOs.[2] Among the allegations in these cases were that members failed

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[2] *Franklin Ross, Inc.*, NASD No. E072004001501 (settled April 2006), summarized in *NASD Notice Disciplinary Actions*, p. 1 (May 2006); *Capital Growth Financial, LLC*, NASD No. E072003099001 (settled February 2006), summarized in *NASD Notice Disciplinary Actions*, p. 1 (April 2006); *Craig & Associates*, NASD No. E3B2003026801 (settled August 2005), summarized in *NASD Notice Disciplinary Actions*, p. D6 (October 2005); *Online Brokerage*

to provide PPMs to investors, or provided PPMs that contained misleading, incorrect or selective disclosure, such as omissions and misrepresentations regarding selling compensation and the use of offering proceeds. In addition, as part of its examination program, FINRA conducted a non-public sweep of firms that had engaged in MPOs and found widespread problems. The MPO sweep revealed that in some cases, offering proceeds were used for individual bonuses, sales contest awards, commissions in excess of 20 percent, or other undisclosed compensation.

Inasmuch as MPOs are private placements, they are not subject to existing FINRA rules governing underwriting terms and arrangements and conflicts of interest by members in public offerings.[3] This proposed rule change is intended to provide investor protections for MPOs that are similar to the protections provided by NASD Rule 2720 for public offerings by members.[4]

Services, Inc., NASD No. C8A050021 (settled March 2005), summarized in *NASD Notice Disciplinary Actions*, p. D5 (May 2005); *IAR Securities/Legend Merchant Group*, NASD No. C10030058 (settled July 2004), summarized in *NASD Notice Disciplinary Actions*, p. D1 (July 2004); *Shelman Securities Corp.*, NASD No. C06030013 (settled December 2003), summarized in *NASD Notice Disciplinary Actions*, p. D1 (February 2004); *Neil Brooks*, NASD No.C06030009 (settled June 2003), summarized in NASD Press Release, NASD Files Three Enforcement Actions for Fraudulent Hedge Fund Offerings (August 18, 2003); *Dep't of Enforcement v. L.H. Ross & Co., Inc.*, Complaint No. CAF040056 (Hearing Panel decision January 15, 2005); *Dep't of Enforcement v. Win Capital Corp.*, Complaint No. CLI030013 (Hearing Panel decision August 6, 2004). In addition to these cases, NASD has numerous ongoing investigations involving MPOs.

3 NASD Rules 2710, 2720 and 2810 govern member participation in *public* offerings of securities.

4 Members would remain subject to other NASD rules that govern a member's participation in the offer and sale of a security, including NASD Rules 2110, 2120 and Rule 2310. Members also are subject to the anti-fraud provisions of the

In response to concerns about MPOs, in June 2007, FINRA issued Notice to Members 07-27 ("NTM 07-27") soliciting comment on a proposed new Rule (then numbered Proposed Rule 2721). FINRA received sixteen comment letters in response to NTM 07-27.[5] The comments were varied. Some commenters expressed support for the intent of the proposed rule, but voiced concerns about its breadth and scope;[6] others questioned the benefit or necessity of the proposed rule.[7] Most comment letters also

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federal securities laws, including Sections 10(b), 11, 12 and 17 of the Exchange Act.

5 The following is a list of persons and entities submitting comment letters in response to NTM 07-27: Letter from Timothy P. Selby for Alston & Bird LLP dated July 20, 2007 (Alston & Bird letter); Letter from Keith F. Higgins for American Bar Association Committee on Federal Regulation of Securities dated July 20, 2007 (ABA letter); Letter from Todd Anders dated July 13, 2007 (Anders letter); Letter from Neville Golvala for ChoiceTrade dated July 19, 2007 (ChoiceTrade letter); Letter from Stephen E. Roth, et al of Sutherland, Asbill & Brennan, LLP for the Committee of Annuity Insurers dated July 20, 2007 (CAI letter); Letter from Peter J Chepucavage for the International Association of Small Broker-Dealers and Advisors dated July 20, 2007 (IASBDA letter); Letter from Alan Z. Engel for LEC Investment Corp. dated June 14, 2007 (LEC letter); Letter from Daniel T. McHugh for Lombard Securities Inc. dated July 20, 2007 (Lombard letter); Letter from Dexter M. Johnson for Mallon & Johnson, P.C. dated July 19, 2007 (Mallon & Johnson letter); Letter from John G. Gaine for Managed Funds Association dated July 20, 2007 (MFA letter); Letter from Curtis N. Sorrells for MGL Consulting Corp. dated July 20, 2007 (MGL letter); Letter from Thomas W. Sexton for the National Futures Association dated July 20, 2007 (NFA letter); Letter from Michael S. Sackheim and David A. Form for the New York City Bar Committee of Futures and Derivatives Regulation dated July 10, 2007 (NYC Bar letter); Letter from Joseph A. Fillip, Jr. for PFG Distribution Co. dated July 19, 2007 (PFG letter); Letter from Mary Kuan for Securities Industry and Financial Markets Association dated July 27, 2007 (SIFMA letter); and Letter from Bill Keisler for Stephens Inc. dated July 20, 2007 (Stephens letter).

6 See MFA letter; CAI letter; Alston & Bird letter.

7 See Anders letter; Mallon & Johnson letter; ChoiceTrade letter; ABA letter; SIFMA letter. FINRA does not agree with SIFMA that the potential for abuses in connection with private offerings by non-members is a reason to abandon the proposed rule change. The staff believes that offerings by members raise unique

suggested edits to the proposed rule.[8] In the discussion below, we discuss the comments and note areas that differ significantly from the rule as previously proposed in NTM 07-27.

Definitions

The proposed rule change states that no member or associated person may offer or sell any security in a MPO unless certain conditions are met. Thus, the proposed rule change uses the term "MPO" as "a private placement of unregistered securities issued by a member or control entity." The proposed rule further defines two of the terms in the definition of MPO: "private placement" and "control entity." In response to one comment,[9] FINRA has defined the term "private placement" to be "a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act."

The proposed rule change defines the term "control entity" as any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons." For purposes of the proposed rule change, the term "control" means "a beneficial interest, as defined in NASD Rule 2790(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

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conflicts that require the protections of the proposed rule change. We also disagree with SIFMA's contention that FINRA does not have legal authority to adopt the proposed rule change.

8 See Alston & Bird letter; ABA letter; LEC letter; Mallon & Johnson letter; MFA letter; MGL letter; PFG letter; SIFMA letter.

9 See ABA letter; SIFMA letter.

entity.[10] The power to direct the management or policies of a corporation or partnership alone (e.g., a general partner) – absent meeting the majority ownership or right to the majority of profits – would not constitute "control" as defined in proposed FINRA Rule 5122. For purposes of this definition, entities may calculate the percentage of control using a "flow through" concept, by looking through ownership levels to calculate the total percentage of control. For example, if broker-dealer ABC owns 50 percent of corporation DEF that in turn holds a 60 percent interest in corporation GHI, and ABC is engaged in a private offering of GHI, ABC would have a 30 percent interest in GHI (50 percent of 60 percent), and thus GHI would not be considered a control entity under this definition.

We also reaffirm, as stated in NTM 07-27, that performance and management fees earned by a general partner would not be included in the determination of partnership profit or loss percentages. However, if such performance and management fees are subsequently re-invested in the partnership, thereby increasing the general partner's ownership interest, then such interests would be considered in determining whether the partnership is a control entity.

In response to several comments advocating that the timing for determining control take place at the conclusion rather than the commencement of an offering,[11] we have revised the definition of control to be determined at the closing of an offering. The

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10 We added language regarding "other non-corporate legal entities" based on commenters' suggestions to clarify that control would extend to entities other than corporations or partnerships. See ABA letter; SIFMA letter.

11 See Alston & Bird letter; ABA letter; LEC letter; MFA letter; MGL letter; NYC Bar letter; SIFMA letter.

definition also clarifies that, in the case of multiple closings, control will be determined at the first closing. If an offering is intended to raise sufficient funds such that the member would not control the entity under the control standard, but fails to raise sufficient funds, the member must promptly come into compliance with the Rule, including providing the required disclosures to investors and filings with FINRA's Corporate Financing Department ("Department").

Filing Requirements

The first substantive requirement under the proposed rule change, in paragraph (b)(1), is that a member file a PPM with the Department at or prior to the first time it is provided to any prospective investor. Any amendments or exhibits to the PPM also must be filed by the member with the Department within ten days of being provided to any prospective investor. The filing requirement is intended to allow the Department to identify those PPMs that are deficient "on their face" from the other requirements of the proposed rule change. Notably, the filing requirement in the proposed rule change differs from that in NASD Rule 2710 (Corporate Financing Rule) in that the Department would not review the offering and issue a "no-objections" letter before a member may commence the offering.

We affirm, in response to concerns raised in the comment letters,[12] that information filed with the Department pursuant to FINRA Rule 5122 would be subject to confidential treatment. We have included a provision in the proposed rule change

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[12] See ABA letter; Mallon & Johnson letter; SIFMA letter.

explicitly clarifying this position.[13] The Department plans to develop a web-based filing system that would allow for the filing to be deemed filed upon submission.[14] In addition, the proposed rule change would not impose any additional requirements regarding filing of advertisements or sales materials, which would continue to be governed by NASD Rule 2210.[15]

One commenter suggested that a member's filing of Form D pursuant to Securities Act Regulation D should provide sufficient information to FINRA.[16] FINRA staff disagrees. For example, we note that the information in Form D may not require disclosure of all of the information required by the proposed rule change, such as use of proceeds, nor require that such information is contained in the PPM.

Disclosure Requirements

The proposed rule change would require that a member provide a PPM to each investor in an MPO, whether accredited or not, and that the PPM disclose the intended use of offering proceeds as well as offering expenses and selling compensation.[17]

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13 See 5122(d). This confidential treatment provision is similar to that provided in NASD Rule 2710(b)(3).

14 As noted in NTM 07-27, neither FINRA nor the Department would issue a "no objections opinion" regarding any PPM filed with the Department. However, if FINRA subsequently determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading, FINRA could make further inquiries. The filing requirement also could facilitate the creation of a confidential Department database on MPO activity that would be used in connection with the member examination process.

15 See NYC Bar letter; SIFMA letter.

16 See Mallon & Johnson letter.

17 Given that FINRA is not imposing limits on selling compensation as it does in, for example, Rule 2710, we do not believe it is necessary to provide a detailed definition of "selling compensation" as urged by SIFMA. We believe that the

FINRA believes that every investor in an MPO should receive this basic information concerning the offering. We believe that none of the disclosures required in the proposed rule change would conflict with requirements under federal or state securities laws.[18]

In response to comments,[19] the proposed rule change eliminates the previously proposed requirements to disclose risk factors and "any other information necessary to ensure that required information is not misleading." One commenter was concerned that requiring PPMs to disclose these items could lead to an inconsistent scheme of regulation in interpreting the application of the federal securities laws to private placements if FINRA's expectation of what should be disclosed differs from the expectations of the SEC and the courts.[20] While we have omitted these disclosures from the proposed rule change, we specifically request comment on our decision to exclude such disclosures.

Use of Offering Proceeds

Proposed Rule 5122(b)(3) would require that each time an MPO is closed at least 85 percent of the offering proceeds raised be used for the business purposes identified in the PPM. This requirement was created to address the abuses where members or control entities used substantial amounts of offering proceeds for selling compensation and related party benefits, rather than business purposes. Importantly, as proposed, the rule does not limit the total amount of underwriting compensation. Rather, under the proposed rule change, offering and other expenses of the MPO could exceed a value

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term "selling compensation" for purposes of a disclosure requirement is sufficiently clear.

18 See SIFMA letter.

19 See ABA letter.

greater than 15 percent of the offering proceeds, but no more than 15 percent of the money raised from investors in the private placement could be used to pay these expenses. We note the 15 percent figure is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 (Direct Participation Programs), and the North American Securities Administrators Association ("NASAA") guidelines with respect to public offerings subject to state regulation.

Some commenters expressed concern that the 85 percent limit was arbitrary or unnecessary[21] and should be reduced or eliminated to allow flexibility for management in MPOs.[22] The staff believes that when a member engages in a private placement of its own securities or those of a control entity, investors should be assured that, at a minimum, 85 percent of the proceeds of the offering are dedicated to the business purposes. We recognize that changing the business purpose or use of proceeds in an offering may in some instances benefit investors, and remind members that the member may change its use of proceeds, provided it makes appropriate disclosure to investors and files the amended PPMs with the Department.

One commenter requested that, when an issuer plans a series of MPOs, the issuer should be allowed to calculate the 85 percent limit at the end of the series.[23] We believe, however, that the limit should apply to *each* MPO in order to assure investors that at least 85 percent of *each* offering in a series is dedicated to the business purposes described in

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20 See ABA letter.

21 See IASBDA letter; Mallon & Johnson letter; ABA letter; SIFMA letter.

22 See IASBDA letter; Mallon & Johnson letter; ABA letter.

23 See NYC Bar letter.

that offering's PPM. As a result, we have clarified that the 85 percent limit applies to each MPO.

Proposed Exemptions

Proposed Rule 5122 would include a number of exemptions for sales to institutional purchasers because the staff's findings did not reveal abuse vis-à-vis such purchasers, who are generally sophisticated and able to conduct appropriate due diligence prior to making an investment. Specifically, the proposed Rule would exempt MPOs sold solely to the following:

- Institutional accounts, as defined in NASD Rule 3110(c)(4);
- Qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;
- Qualified institutional buyers, as defined in Securities Act Rule 144A;
- Investment companies, as defined in Section 3 of the Investment Company Act;
- An entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A; and
- Banks, as defined in Section 3(a)(2) of the Securities Act.

In addition, the proposed rule change excludes the following types of offerings, which do not raise the concerns identified in the sweep or enforcement actions:

- offerings of exempted securities, as defined by Section 3(a)(12) of the Exchange Act;
- offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;
- offerings in which a member 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% 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 SEA Rule 15c3-1, Appendix D;
- offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);
- offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referred to in NASD Rule 2710(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 the Department under NASD Rules 2710, 2720 or 2810.

Finally, the proposed rule change also would exempt MPOs in which investors would be expected to have access to sufficient information about the issuer and its securities in addition to the information provided by the member conducting the MPO. These exemptions include:

- offerings of unregistered investment grade rated debt and preferred securities;
- offerings to employees and affiliates of the issuer or its control entities; and
- offerings of securities issued in conversions, stock splits and restructuring transactions executed by an already existing investor without the need for additional consideration or investments on the part of the investor.

This list of exemptions is largely based on the exemptions previously proposed in NTM 07-27, with a few additions and clarifications in response to comments.[24] We clarified that exempted securities, as defined by Section 3(a)(12) of the Exchange Act,

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[24] See Lombard letter; ABA letter; MGL letter; NYC Bar letter; MFA letter; NFA letter; Alston & Bird letter; Anders letter; PFG letter; CAI letter; ChoiceTrade letter; Mallon & Johnson letter; SIFMA letter.

would not be subject to the Rule.[25] In addition, we propose an exemption for commodity pools[26] in view of the oversight and regulation performed by the National Futures Association and the Commodity Futures Trading Commission. We also clarified that variable contracts and other life insurance products[27] would be excluded, because the offer and sale of these types of offerings are already subject to existing NASD rules.[28] We also propose an exemption for member private offerings that are filed with the Department under NASD Rules 2710, 2720 or 2810.

In addition, we clarified aspects of other previously proposed exemptions. We clarified that our intent regarding the exemption for wholesalers is to provide an exemption for those that do not primarily engage in direct selling to investors.[29] We also clarified that 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 investment on the part of the investor would be exempt.[30]

We also noted that equity and credit derivatives, such as OTC options, would be exempt, provided that the derivative is not based principally on the member or any of its

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25 Accordingly, we note that in connection with this proposed Rule, we do not plan to recommend amending NASD Rule 0116 or the List of NASD Conduct Rules and Interpretive Materials that apply to Exempted Securities. See CAI letter.

26 See NYC Bar letter; MFA letter; NFA letter; Alston & Bird letter; SIFMA letter.

27 See CAI letter; PFG letter.

28 See, e.g., NASD Rule 2820.

29 See MGL letter; SIFMA letter.

30 See Mallon & Johnson letter.

control entities.[31] As a technical matter, the issuer of an equity or credit derivative is the member firm, and thus would make such offering an MPO. However, where the security offered is not based principally on the member or any of its control entities (e.g., an OTC option on MSFT), FINRA does not believe such sale should be subject to the provisions of the proposed rule change. On the other hand, if the derivative is based principally on the member or a control entity (e.g., an OTC option overlying the member), then the sale of such security should be treated as an MPO and subject to the requirements of the proposed rule change.

Finally, we clarified that the exemption for employees and affiliates of issuers would apply to employees and affiliates of control entities as well, because these persons are expected to have access to a level of information about the securities of the issuer similar to employees and affiliates of the issuer itself.[32]

Based on the comment letters,[33] we also reconsidered whether offerings to accredited investors should be exempt. However, we continue to believe that an exemption for offerings made to accredited investors would not be in the public interest due to the generally low thresholds for meeting the definition of the term "accredited investor." We note that the SEC has recently proposed clarifying and modernizing its "accredited investor" standard due to concerns that the definition is overbroad.[34]

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31 See SIFMA letter.

32 See Stephens letter; see also Lombard letter.

33 See ChoiceTrade letter; PFG letter; SIFMA letter.

34 See, e.g., Securities Act Release No, 8828 (Aug. 3, 2007), 72 FR 45116 (Aug. 10, 2007); Securities Act Release No. 8766 (Dec. 27, 2006), 72 FR 400 (Jan. 4, 2007).

Additionally, it is our view that financial products offered by a public reporting company,[35] an investment fund[36] or a state or federal bank affiliate of a FINRA member[37] should not be excluded based solely on their status as a reporting company, a fund or a bank. Our belief is that, as a general matter, exemptions are best tailored based on the type of securities offered or the type (and sophistication) of the purchaser rather than the type of offeror. We also decline to exempt offerings that contribute below a specified level of a member's net worth (e.g., 5 %), to create a categorical exemption for all exempted securities under Section 3(a) of the Securities Act, or to expand the exemption for securities with short term maturities under Section 3(a)(3) of the Securities Act to include all securities with a maturity of nine months or less.[38] As a practical matter, however, many of these products would be exempt because they meet one of the other exemptions enumerated in the rule.

Implementation and Compliance

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval, but will not apply retroactively to any offerings that have already commenced selling efforts.

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35 See ABA letter; SIFMA letter.

36 See MFA letter.

37 See Anders letter; ABA letter.

38 See SIFMA letter.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[39] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes the proposed rule change will provide important investor protections in connection with private placements of securities by members and control entities.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published in Notice to Members 07-27 (June 2007). Sixteen comments were received in response to Notice to Members 07-27. A copy of Notice to Members 07-27 is attached as Exhibit 2a. A list of the comment letters received in response to Notice to Members 07-27 is attached as Exhibit 2b. Copies of the comment letters received in response to Notice to Members 07-27 are attached as Exhibit 2c. The comments are summarized above.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for

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[39] 15 U.S.C. 78o–3(b)(6).

Commission action specified in Section 19(b)(2) of the Act.[40]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2. NASD Notice to Members 07-27 and comments received in response to NASD Notice to Members 07-27. A copy of Notice to Members 07-27 is attached as Exhibit 2a. A list of the comment letters received in response to Notice to Members 07-27 is attached as Exhibit 2b. Copies of the comment letters received in response to Notice to Members 07-27 are attached as Exhibit 2c.

[40] 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2008-020)

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Private Placements of Securities Issued by Members

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt new FINRA Rule 5122. This proposed rule change would require a member that engages in a private placement of unregistered securities issued by the member or a control entity to (1) make certain disclosures to investors in a private placement memorandum ("PPM"), (2) file the PPM with FINRA, and (3) commit that at least 85 percent of the offering proceeds will be used for the business purposes identified in the PPM. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

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5120. Offerings of Members' Securities

* * * * *

5122. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering

A private placement of unregistered securities issued by a member or a control entity.

(2) Control Entity

Any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons. The term "control" for purposes of this Rule means beneficial interest, as defined in NASD Rule 2790(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. In the case of multiple closings, control will be determined at the first closing.

(3) Private Placement

A non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act.

(b) Requirements

No member or associated person may offer or sell any security in a Member Private Offering unless the following conditions have been met:

(1) Filing Requirements

A private placement memorandum must be filed with the Corporate Financing Department ("Department") at or prior to the first time the private placement memorandum is provided to any prospective investor. An amendment or exhibit to the private placement memorandum also must be filed with the Department within ten days of being provided to any investor.

(2) Disclosure Requirements

A private placement memorandum must be provided to each prospective investor and the private placement memorandum must disclose:

(A) intended use of the offering proceeds; and

(B) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons.

(3) Use of Offering Proceeds

At each time a Member Private Offering is closed, at least 85 percent of the offering proceeds raised must be used for the business purpose identified in the "intended use of the offering proceeds" disclosure in the private placement memorandum.

If, in connection with the offer and sale of any security in a Member Private Offering, a member or associated person discovers after the fact that one or more of the conditions listed above have not been met, the member or associated person must promptly conform the offering to comply with this Rule.

(c) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) offerings sold solely to:

(A) institutional accounts, as defined in NASD Rule 3110(c)(4);

(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; and

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

(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 in which a member 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% of the securities in the offering);

(5) offerings of exempted securities with short term maturities under Section 3(a)(3) of the Securities Act;

(6) offerings of subordinated loans under SEA Rule 15c3-1, Appendix D;

(7) offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);

(8) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in NASD Rule 2710(b)(8)(E);

(9) offerings of unregistered investment grade rated debt and preferred securities;

(10) offerings to employees and affiliates of the issuer or its control entities;

(11) 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;

(12) offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(5) of the Commodity Exchange Act;

(13) offerings of equity and credit derivatives, including OTC options; provided that the derivative is not based principally on the member or any if its control entities; and

(14) offerings filed with the Department under NASD Rules 2710, 2720 or 2810.

(d) Confidential Treatment

FINRA shall accord confidential treatment to all documents and information filed pursuant to this Rule and shall utilize such documents and information solely for the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

(e) Application for Exemption

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background and Discussion

FINRA is proposing new FINRA Rule 5122 in response to problems identified in connection with private placements by members of their own securities or those of a control entity (referred to as "Member Private Offerings" or "MPOs"). In recent years,

FINRA has investigated and brought numerous enforcement cases concerning abuses in connection with MPOs.[3] Among the allegations in these cases were that members failed to provide PPMs to investors, or provided PPMs that contained misleading, incorrect or selective disclosure, such as omissions and misrepresentations regarding selling compensation and the use of offering proceeds. In addition, as part of its examination program, FINRA conducted a non-public sweep of firms that had engaged in MPOs and found widespread problems. The MPO sweep revealed that in some cases, offering proceeds were used for individual bonuses, sales contest awards, commissions in excess of 20 percent, or other undisclosed compensation.

Inasmuch as MPOs are private placements, they are not subject to existing FINRA rules governing underwriting terms and arrangements and conflicts of interest by members in public offerings.[4] This proposed rule change is intended to provide investor

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3 *Franklin Ross, Inc.*, NASD No. E072004001501 (settled April 2006), summarized in *NASD Notice Disciplinary Actions*, p. 1 (May 2006); *Capital Growth Financial, LLC*, NASD No. E072003099001 (settled February 2006), summarized in *NASD Notice Disciplinary Actions*, p. 1 (April 2006); *Craig & Associates*, NASD No. E3B2003026801 (settled August 2005), summarized in *NASD Notice Disciplinary Actions*, p. D6 (October 2005); *Online Brokerage Services, Inc.*, NASD No. C8A050021 (settled March 2005), summarized in *NASD Notice Disciplinary Actions*, p. D5 (May 2005); *IAR Securities/Legend Merchant Group*, NASD No. C10030058 (settled July 2004), summarized in *NASD Notice Disciplinary Actions*, p. D1 (July 2004); *Shelman Securities Corp.*, NASD No. C06030013 (settled December 2003), summarized in *NASD Notice Disciplinary Actions*, p. D1 (February 2004); *Neil Brooks*, NASD No.C06030009 (settled June 2003), summarized in NASD Press Release, NASD Files Three Enforcement Actions for Fraudulent Hedge Fund Offerings (August 18, 2003); *Dep't of Enforcement v. L.H. Ross & Co., Inc.*, Complaint No. CAF040056 (Hearing Panel decision January 15, 2005); *Dep't of Enforcement v. Win Capital Corp.*, Complaint No. CLI030013 (Hearing Panel decision August 6, 2004). In addition to these cases, NASD has numerous ongoing investigations involving MPOs.

4 NASD Rules 2710, 2720 and 2810 govern member participation in *public* offerings of securities.

protections for MPOs that are similar to the protections provided by NASD Rule 2720 for public offerings by members.[5]

In response to concerns about MPOs, in June 2007, FINRA issued Notice to Members 07-27 ("NTM 07-27") soliciting comment on a proposed new Rule (then numbered Proposed Rule 2721). FINRA received sixteen comment letters in response to NTM 07-27.[6] The comments were varied. Some commenters expressed support for the intent of the proposed rule, but voiced concerns about its breadth and scope;[7] others

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5 Members would remain subject to other NASD rules that govern a member's participation in the offer and sale of a security, including NASD Rules 2110, 2120 and Rule 2310. Members also are subject to the anti-fraud provisions of the federal securities laws, including Sections 10(b), 11, 12 and 17 of the Exchange Act.

6 The following is a list of persons and entities submitting comment letters in response to NTM 07-27: Letter from Timothy P. Selby for Alston & Bird LLP dated July 20, 2007 (Alston & Bird letter); Letter from Keith F. Higgins for American Bar Association Committee on Federal Regulation of Securities dated July 20, 2007 (ABA letter); Letter from Todd Anders dated July 13, 2007 (Anders letter); Letter from Neville Golvala for ChoiceTrade dated July 19, 2007 (ChoiceTrade letter); Letter from Stephen E. Roth, et al of Sutherland, Asbill & Brennan, LLP for the Committee of Annuity Insurers dated July 20, 2007 (CAI letter); Letter from Peter J Chepucavage for the International Association of Small Broker-Dealers and Advisors dated July 20, 2007 (IASBDA letter); Letter from Alan Z. Engel for LEC Investment Corp. dated June 14, 2007 (LEC letter); Letter from Daniel T. McHugh for Lombard Securities Inc. dated July 20, 2007 (Lombard letter); Letter from Dexter M. Johnson for Mallon & Johnson, P.C. dated July 19, 2007 (Mallon & Johnson letter); Letter from John G. Gaine for Managed Funds Association dated July 20, 2007 (MFA letter); Letter from Curtis N. Sorrells for MGL Consulting Corp. dated July 20, 2007 (MGL letter); Letter from Thomas W. Sexton for the National Futures Association dated July 20, 2007 (NFA letter); Letter from Michael S. Sackheim and David A. Form for the New York City Bar Committee of Futures and Derivatives Regulation dated July 10, 2007 (NYC Bar letter); Letter from Joseph A. Fillip, Jr. for PFG Distribution Co. dated July 19, 2007 (PFG letter); Letter from Mary Kuan for Securities Industry and Financial Markets Association dated July 27, 2007 (SIFMA letter); and Letter from Bill Keisler for Stephens Inc. dated July 20, 2007 (Stephens letter).

7 See MFA letter; CAI letter; Alston & Bird letter.

questioned the benefit or necessity of the proposed rule.[8] Most comment letters also suggested edits to the proposed rule.[9] In the discussion below, we discuss the comments and note areas that differ significantly from the rule as previously proposed in NTM 07-27.

Definitions

The proposed rule change states that no member or associated person may offer or sell any security in a MPO unless certain conditions are met. Thus, the proposed rule change uses the term "MPO" as "a private placement of unregistered securities issued by a member or control entity." The proposed rule further defines two of the terms in the definition of MPO: "private placement" and "control entity." In response to one comment,[10] FINRA has defined the term "private placement" to be "a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act."

The proposed rule change defines the term "control entity" as any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons." For purposes of the proposed rule change, the term "control" means "a beneficial interest, as defined in NASD Rule 2790(i)(1), of more than 50

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8 See Anders letter; Mallon & Johnson letter; ChoiceTrade letter; ABA letter; SIFMA letter. FINRA does not agree with SIFMA that the potential for abuses in connection with private offerings by non-members is a reason to abandon the proposed rule change. The staff believes that offerings by members raise unique conflicts that require the protections of the proposed rule change. We also disagree with SIFMA's contention that FINRA does not have legal authority to adopt the proposed rule change.

9 See Alston & Bird letter; ABA letter; LEC letter; Mallon & Johnson letter; MFA letter; MGL letter; PFG letter; SIFMA letter.

10 See ABA letter; SIFMA letter.

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.[11] The power to direct the management or policies of a corporation or partnership alone (e.g., a general partner) – absent meeting the majority ownership or right to the majority of profits – would not constitute "control" as defined in proposed FINRA Rule 5122. For purposes of this definition, entities may calculate the percentage of control using a "flow through" concept, by looking through ownership levels to calculate the total percentage of control. For example, if broker-dealer ABC owns 50 percent of corporation DEF that in turn holds a 60 percent interest in corporation GHI, and ABC is engaged in a private offering of GHI, ABC would have a 30 percent interest in GHI (50 percent of 60 percent), and thus GHI would not be considered a control entity under this definition.

We also reaffirm, as stated in NTM 07-27, that performance and management fees earned by a general partner would not be included in the determination of partnership profit or loss percentages. However, if such performance and management fees are subsequently re-invested in the partnership, thereby increasing the general partner's ownership interest, then such interests would be considered in determining whether the partnership is a control entity.

In response to several comments advocating that the timing for determining control take place at the conclusion rather than the commencement of an offering,[12] we

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11 We added language regarding "other non-corporate legal entities" based on commenters' suggestions to clarify that control would extend to entities other than corporations or partnerships. See ABA letter; SIFMA letter.

12 See Alston & Bird letter; ABA letter; LEC letter; MFA letter; MGL letter; NYC Bar letter; SIFMA letter.

have revised the definition of control to be determined at the closing of an offering. The definition also clarifies that, in the case of multiple closings, control will be determined at the first closing. If an offering is intended to raise sufficient funds such that the member would not control the entity under the control standard, but fails to raise sufficient funds, the member must promptly come into compliance with the Rule, including providing the required disclosures to investors and filings with FINRA's Corporate Financing Department ("Department").

Filing Requirements

The first substantive requirement under the proposed rule change, in paragraph (b)(1), is that a member file a PPM with the Department at or prior to the first time it is provided to any prospective investor. Any amendments or exhibits to the PPM also must be filed by the member with the Department within ten days of being provided to any prospective investor. The filing requirement is intended to allow the Department to identify those PPMs that are deficient "on their face" from the other requirements of the proposed rule change. Notably, the filing requirement in the proposed rule change differs from that in NASD Rule 2710 (Corporate Financing Rule) in that the Department would not review the offering and issue a "no-objections" letter before a member may commence the offering.

We affirm, in response to concerns raised in the comment letters,[13] that information filed with the Department pursuant to FINRA Rule 5122 would be subject to confidential treatment. We have included a provision in the proposed rule change

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13 See ABA letter; Mallon & Johnson letter; SIFMA letter.

explicitly clarifying this position.[14] The Department plans to develop a web-based filing system that would allow for the filing to be deemed filed upon submission.[15] In addition, the proposed rule change would not impose any additional requirements regarding filing of advertisements or sales materials, which would continue to be governed by NASD Rule 2210.[16]

One commenter suggested that a member's filing of Form D pursuant to Securities Act Regulation D should provide sufficient information to FINRA.[17] FINRA staff disagrees. For example, we note that the information in Form D may not require disclosure of all of the information required by the proposed rule change, such as use of proceeds, nor require that such information is contained in the PPM.

Disclosure Requirements

The proposed rule change would require that a member provide a PPM to each investor in an MPO, whether accredited or not, and that the PPM disclose the intended use of offering proceeds as well as offering expenses and selling compensation.[18] FINRA

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14 See 5122(d). This confidential treatment provision is similar to that provided in NASD Rule 2710(b)(3).

15 As noted in NTM 07-27, neither FINRA nor the Department would issue a "no objections opinion" regarding any PPM filed with the Department. However, if FINRA subsequently determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading, FINRA could make further inquiries. The filing requirement also could facilitate the creation of a confidential Department database on MPO activity that would be used in connection with the member examination process.

16 See NYC Bar letter; SIFMA letter.

17 See Mallon & Johnson letter.

18 Given that FINRA is not imposing limits on selling compensation as it does in, for example, Rule 2710, we do not believe it is necessary to provide a detailed definition of "selling compensation" as urged by SIFMA. We believe that the

believes that every investor in an MPO should receive this basic information concerning the offering. We believe that none of the disclosures required in the proposed rule change would conflict with requirements under federal or state securities laws.[19]

In response to comments,[20] the proposed rule change eliminates the previously proposed requirements to disclose risk factors and "any other information necessary to ensure that required information is not misleading." One commenter was concerned that requiring PPMs to disclose these items could lead to an inconsistent scheme of regulation in interpreting the application of the federal securities laws to private placements if FINRA's expectation of what should be disclosed differs from the expectations of the SEC and the courts.[21] While we have omitted these disclosures from the proposed rule change, we specifically request comment on our decision to exclude such disclosures.

Use of Offering Proceeds

Proposed Rule 5122(b)(3) would require that each time an MPO is closed at least 85 percent of the offering proceeds raised be used for the business purposes identified in the PPM. This requirement was created to address the abuses where members or control entities used substantial amounts of offering proceeds for selling compensation and related party benefits, rather than business purposes. Importantly, as proposed, the rule does not limit the total amount of underwriting compensation. Rather, under the proposed rule change, offering and other expenses of the MPO could exceed a value

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term "selling compensation" for purposes of a disclosure requirement is sufficiently clear.

19 See SIFMA letter.

20 See ABA letter.

21 See ABA letter; SIFMA letter.

greater than 15 percent of the offering proceeds, but no more than 15 percent of the money raised from investors in the private placement could be used to pay these expenses. We note the 15 percent figure is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 (Direct Participation Programs), and the North American Securities Administrators Association ("NASAA") guidelines with respect to public offerings subject to state regulation.

Some commenters expressed concern that the 85 percent limit was arbitrary or unnecessary[22] and should be reduced or eliminated to allow flexibility for management in MPOs.[23] The staff believes that when a member engages in a private placement of its own securities or those of a control entity, investors should be assured that, at a minimum, 85 percent of the proceeds of the offering are dedicated to the business purposes. We recognize that changing the business purpose or use of proceeds in an offering may in some instances benefit investors, and remind members that the member may change its use of proceeds, provided it makes appropriate disclosure to investors and files the amended PPMs with the Department.

One commenter requested that, when an issuer plans a series of MPOs, the issuer should be allowed to calculate the 85 percent limit at the end of the series.[24] We believe, however, that the limit should apply to *each* MPO in order to assure investors that at least 85 percent of *each* offering in a series is dedicated to the business purposes described in

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22 See IASBDA letter; Mallon & Johnson letter; ABA letter; SIFMA letter.

23 See IASBDA letter; Mallon & Johnson letter ; ABA letter.

24 See NYC Bar letter.

that offering's PPM. As a result, we have clarified that the 85 percent limit applies to each MPO.

Proposed Exemptions

Proposed Rule 5122 would include a number of exemptions for sales to institutional purchasers because the staff's findings did not reveal abuse vis-à-vis such purchasers, who are generally sophisticated and able to conduct appropriate due diligence prior to making an investment. Specifically, the proposed Rule would exempt MPOs sold solely to the following:

- Institutional accounts, as defined in NASD Rule 3110(c)(4);
- Qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;
- Qualified institutional buyers, as defined in Securities Act Rule 144A;
- Investment companies, as defined in Section 3 of the Investment Company Act;
- An entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A; and
- Banks, as defined in Section 3(a)(2) of the Securities Act.

In addition, the proposed rule change excludes the following types of offerings, which do not raise the concerns identified in the sweep or enforcement actions:

- offerings of exempted securities, as defined by Section 3(a)(12) of the Exchange Act;
- offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;
- offerings in which a member 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% 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 SEA Rule 15c3-1, Appendix D;
- offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);
- offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referred to in NASD Rule 2710(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 the Department under NASD Rules 2710, 2720 or 2810.

Finally, the proposed rule change also would exempt MPOs in which investors would be expected to have access to sufficient information about the issuer and its securities in addition to the information provided by the member conducting the MPO. These exemptions include:

- offerings of unregistered investment grade rated debt and preferred securities;
- offerings to employees and affiliates of the issuer or its control entities; and
- offerings of securities issued in conversions, stock splits and restructuring transactions executed by an already existing investor without the need for additional consideration or investments on the part of the investor.

This list of exemptions is largely based on the exemptions previously proposed in NTM 07-27, with a few additions and clarifications in response to comments.[25] We clarified that exempted securities, as defined by Section 3(a)(12) of the Exchange Act,

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[25] See Lombard letter; ABA letter; MGL letter; NYC Bar letter; MFA letter; NFA letter; Alston & Bird letter; Anders letter; PFG letter; CAI letter; ChoiceTrade letter; Mallon & Johnson letter; SIFMA letter.

would not be subject to the Rule.[26] In addition, we propose an exemption for commodity pools[27] in view of the oversight and regulation performed by the National Futures Association and the Commodity Futures Trading Commission. We also clarified that variable contracts and other life insurance products[28] would be excluded, because the offer and sale of these types of offerings are already subject to existing NASD rules.[29] We also propose an exemption for member private offerings that are filed with the Department under NASD Rules 2710, 2720 or 2810.

In addition, we clarified aspects of other previously proposed exemptions. We clarified that our intent regarding the exemption for wholesalers is to provide an exemption for those that do not primarily engage in direct selling to investors.[30] We also clarified that 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 investment on the part of the investor would be exempt.[31]

We also noted that equity and credit derivatives, such as OTC options, would be exempt, provided that the derivative is not based principally on the member or any of its

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26 Accordingly, we note that in connection with this proposed Rule, we do not plan to recommend amending NASD Rule 0116 or the List of NASD Conduct Rules and Interpretive Materials that apply to Exempted Securities. See CAI letter.

27 See NYC Bar letter; MFA letter; NFA letter; Alston & Bird letter; SIFMA letter.

28 See CAI letter; PFG letter.

29 See, e.g., NASD Rule 2820.

30 See MGL letter; SIFMA letter.

31 See Mallon & Johnson letter.

control entities.[32] As a technical matter, the issuer of an equity or credit derivative is the member firm, and thus would make such offering an MPO. However, where the security offered is not based principally on the member or any of its control entities (e.g., an OTC option on MSFT), FINRA does not believe such sale should be subject to the provisions of the proposed rule change. On the other hand, if the derivative is based principally on the member or a control entity (e.g., an OTC option overlying the member), then the sale of such security should be treated as an MPO and subject to the requirements of the proposed rule change.

Finally, we clarified that the exemption for employees and affiliates of issuers would apply to employees and affiliates of control entities as well, because these persons are expected to have access to a level of information about the securities of the issuer similar to employees and affiliates of the issuer itself.[33]

Based on the comment letters,[34] we also reconsidered whether offerings to accredited investors should be exempt. However, we continue to believe that an exemption for offerings made to accredited investors would not be in the public interest due to the generally low thresholds for meeting the definition of the term "accredited investor." We note that the SEC has recently proposed clarifying and modernizing its "accredited investor" standard due to concerns that the definition is overbroad.[35]

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32 See SIFMA letter.

33 See Stephens letter; see also Lombard letter.

34 See ChoiceTrade letter; PFG letter.

35 See, e.g., Securities Act Release No. 8828 (Aug. 3, 2007), 72 FR 45116 (Aug. 10, 2007); Securities Act Release No. 8766 (Dec. 27, 2006), 72 FR 400 (Jan. 4, 2007).

Additionally, it is our view that financial products offered by a public reporting company,[36] an investment fund[37] or a state or federal bank affiliate of a FINRA member[38] should not be excluded based solely on their status as a reporting company, a fund or a bank. Our belief is that, as a general matter, exemptions are best tailored based on the type of securities offered or the type (and sophistication) of the purchaser rather than the type of offeror. We also decline to exempt offerings that contribute below a specified level of a member's net worth (e.g., 5 %), to create a categorical exemption for all exempted securities under Section 3(a) of the Securities Act, or to expand the exemption for securities with short term maturities under Section 3(a)(3) of the Securities Act to include all securities with a maturity of nine months or less.[39] As a practical matter, however, many of these products would be exempt because they meet one of the other exemptions enumerated in the rule.

Implementation and Compliance

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval, but will not apply retroactively to any offerings that have already commenced selling efforts.

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36 See ABA letter; SIFMA letter.

37 See MFA letter.

38 See Anders letter; ABA letter.

39 See SIFMA letter.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[40] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes the proposed rule change will provide important investor protections in connection with private placements of securities by members and control entities.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published in Notice to Members 07-27 (June 2007). Sixteen comments were received in response to Notice to Members 07-27. A copy of Notice to Members 07-27 is attached as Exhibit 2a. A list of the comment letters received in response to Notice to Members 07-27 is attached as Exhibit 2b. Copies of the comment letters received in response to Notice to Members 07-27 are attached as Exhibit 2c. The comments are summarized above.

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40 15 U.S.C. 78o–3(b)(6).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2008-020 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Florence Harmon, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2008-020. This file number should be included on the subject line if e-mail is used. To help the Commission process

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-020 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[41]

Florence Harmon

Deputy Secretary

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41 17 CFR 200.30-3(a)(12).

Exhibit 2a

Notice to Members

JUNE 2007

SUGGESTED ROUTING

Corporate Financing
Executive Representatives
Legal & Compliance
Senior Management
Operations

KEY TOPICS

Affiliates
Control Entity
Institutional Accounts
Member Private Offerings
Private Placements
Private Placement Memorandum
Regulation D

REQUEST FOR COMMENT

Member Private Offerings

NASD Requests Comment on Proposed Rule 2721 to Regulate Member Private Securities Offerings; **Comment Period Expires July 20, 2007**

Executive Summary

NASD is issuing this *Notice to Members* to solicit comments from members and other interested parties on proposed Rule 2721 pertaining to private placements of unregistered securities issued by a member (Member Private Offerings or MPOs), which would require that:

- a private placement memorandum (PPM) be provided to each investor with information regarding risk factors, intended use of proceeds, offering expenses and any other information necessary to ensure that required information is not misleading;
- the PPM be filed with NASD's Corporate Financing Department at or prior to the time it is provided to any investor; and
- at least 85 percent of the offering proceeds be used for the business purposes identified under the "use of proceeds" disclosure in the PPM.

Rule 2721 is proposed in response to problems NASD has identified in connection with the private offerings of members' securities or those of a control entity. The proposed Rule also contains several exemptions for offerings to certain types of institutional investors, offerings under various provisions of the federal securities laws for which NASD believes the protections of the proposed rule are not necessary, and offerings in which investors otherwise would be expected to have access to sufficient information about the issuer.

Action Requested

NASD encourages all interested parties to comment on the proposal. Comments must be received by July 20, 2007. Members and other interested parties can submit their comments through the following methods:

- Mailing comments in hard copy to the address below; or
- Emailing written comments to *pubcom@nasd.com.*

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method. Comments sent by hard copy should be mailed to:

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Important Notes: The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week after the end of the comment period.[1]

Before becoming effective, a proposed rule change (or certain policies) must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication for public comment in the Federal Register.[2]

Questions/Further Information

As noted above, hard copy comments should be mailed to Barbara Z. Sweeney. Questions concerning this *Notice* may be directed to Thomas M. Selman, Executive Vice President, Investment Companies/Corporate Financing, at (240) 386-4533; Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8104; or Joseph E. Price, Vice President, Corporate Financing, at (240) 386-4623.

Background and Discussion

In recent years, NASD has brought numerous enforcement cases concerning abuses in connection with Member Private Offerings.[3] In addition, NASD conducted a sweep of firms that had engaged in MPOs and found widespread problems. Allegations in these cases include the failure to provide PPMs to investors, as well as misleading, incorrect or selective disclosure in PPMs that were provided, including omissions and misrepresentations regarding selling compensation and the use of offering proceeds.[4]

Typically, MPOs are private placements that rely on the SEC Regulation D exemption from the registration and disclosure requirements in the Securities Act of 1933 (Securities Act).[5] Inasmuch as MPOs are *private* placements, they are not subject to the existing NASD rules governing underwriting terms and arrangements in *public* offerings and conflicts of interest by members that participate in *public* offerings.[6]

1. Proposed Rule 2721

A. Offerings by Members or a Control Entity

Proposed Rule 2721 (set forth in Attachment A) would establish disclosure and filing requirements and limits on offering expenses for private placements by members of their own securities or those of a "control entity." A "control entity" for purposes of the proposed rule would be defined as an entity that controls, is controlled by or is under common control with a member or its associated persons. The term "control" for purposes of the proposed rule would be determined based on beneficial ownership 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.[7] The power to direct the management or policies of a corporation or partnership alone (*e.g.*, a general partner)—absent meeting the majority ownership or right to the majority of profits—would not constitute "control" for the control entity definition in the proposed rule.

B. Disclosure Requirements

Proposed Rule 2721 would require members to provide each investor in an MPO (whether accredited or unaccredited) by a member or a control affiliate with a PPM that contains the following information:

- risk factors associated with the investment, including company risks, industry risks and market risks;
- intended use of offering proceeds;
- offering expenses and selling compensation; and
- any other information necessary to ensure that the required information is not misleading.

This requirement would help ensure that every investor in an MPO by a member or a control entity receives basic information concerning the nature of the offering.

C. Filing Requirements

The proposed rule also would require members to file the PPM with NASD at or prior to the first time the PPM is provided to any investor. In addition, any amendment or exhibit to the PPM would be required to be filed with NASD within ten days of being provided to any investor. However, unlike filings with NASD under Rules 2710, 2720 and 2810, a member could begin offering MPO securities immediately after filing the PPM.[8]

D. Use of Offering Proceeds

Proposed Rule 2721 would require that at least 85 percent of the offering proceeds of an MPO be used for the business purposes identified in the PPM. This condition is in response to abuses we have seen where substantial amounts of offering proceeds have been dedicated to purposes other than the business purpose identified in the PPM, including selling compensation and related party benefits.[9] Consequently, under the proposed rule, offering and other expenses of the MPO could not exceed 15 percent of the offering proceeds. This figure is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 (Direct Participation Programs), and the North American Securities Administrators Association (NASAA) guidelines with respect to public offerings subject to state regulation. When a member engages in a private placement of its own securities or those of a control entity, investors should be assured that, at a minimum, 85 percent of the proceeds of the offering are dedicated to the business purposes described in the PPM. We request comment on whether this threshold is appropriate.

E. Proposed Exemptions

Proposed Rule 2721 would include several exemptions. Specifically, the proposed Rule would exempt MPOs sold solely to:

- institutional accounts (as defined in NASD Rule 3110(c)(4));
- qualified purchasers (as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940);
- qualified institutional buyers (as defined in SEC Rule 144A of the Securities Act);
- investment companies (as defined in Rule SEC Rule 144A);
- an entity composed exclusively of qualified institutional buyers (as defined in SEC Rule 144A); and
- banks (as defined in SEC Rule 144A).

In addition, the following types of offerings would be exempt from the proposed rule:

- offerings made pursuant to SEC Rule 144A or SEC Regulation S;
- offerings in which a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers;
- offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act; and
- offerings of subordinated loans under SEC Rule 15c3-1, Appendix D.

Finally, the proposed rule also would exempt MPOs in which investors would be expected to have access to sufficient information about the issuer and its securities in addition to the information provided by the member conducting the MPO. These include exemptions for:

- offerings of unregistered investment grade rated debt;
- offerings to employees and affiliates of the issuer; and
- offerings of securities issued in stock splits and restructuring transactions.

F. Scope of Proposed Rule 2721

Proposed Rule 2721 is intended to provide investor protections with respect to private offerings by a member that are parallel, but not identical, to the protections provided by Rule 2720 with respect to a member's public offerings.[10] Therefore, Rule 2721, like Rule 2720, would apply only to private placements by a member or its control entities. The proposed rule would apply to offerings by an entity that is under common control with the member, or that the member firm or its associated persons control. For purposes of proposed Rule 2721, "control" is defined as beneficial ownership of more than 50 percent of the outstanding voting securities if the entity is a corporation, or in the case of a partnership, more than a 50 percent interest in its distributable profits or losses.[11]

Consequently, proposed Rule 2721 would not apply to private placements by any entity that does not meet this control test, including investment partnerships, direct participation programs, and other private funds that the member might organize but in which the member, its associated persons, or any parent of the member does not beneficially own the requisite ownership position. NASD requests comment on whether the proposed rule should apply to these other entities.

Endnotes

1 *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or email addresses, will not be edited from submissions. Submit only information you wish to make publicly available.

2 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. *See* Exchange Act Section 19 and the rules thereunder.

3 *E.g., Franklin Ross, Inc.*, NASD No. E072004001501 (settled April 2006), summarized in *NASD NTM Disciplinary Actions*, p. 1 (May 2006); *Capital Growth Financial, LLC*, NASD No. E072003099001 (settled February 2006), summarized in *NASD NTM Disciplinary Actions*, p. 1 (April 2006); *Craig & Associates*, NASD No. E3B2003026801 (settled August 2005), summarized in *NASD NTM Disciplinary Actions*, p. D6 (October 2005); *Online Brokerage Services, Inc.*, NASD No. C8A050021 (settled March 2005), summarized in *NASD NTM Disciplinary Actions*, p. D5 (May 2005); *IAR Securities/Legend Merchant Group*, NASD No. C10030058 (settled July 2004), summarized in *NASD NTM Disciplinary Actions*, p. D1 (July 2004); *Shelman Securities Corp.*, NASD No. C06030013 (settled December 2003), summarized in *NASD NTM Disciplinary Actions*, p. D1 (February 2004); *Neil Brooks*, NASD No. C06030009 (settled June 2003), summarized in NASD Press Release, NASD Files Three Enforcement Actions for Fraudulent Hedge Fund Offerings (August 18, 2003); *Dep't of Enforcement v. L.H. Ross & Co., Inc.*, Complaint No. CAF040056 (Hearing Panel decision January 15, 2005); *Dep't of Enforcement v. Win Capital Corp.*, Complaint No. CLI030013 (Hearing Panel decision August 6, 2004). In addition to these cases, NASD has numerous ongoing investigations involving MPOs.

4 SEC Regulation D does not require disclosure documents to be prepared or provided in offerings made solely to accredited investors. However, in some MPOs, NASD found that no PPM was prepared even though sales were made to persons who are not accredited investors. In others, a PPM was prepared, but it was not provided to certain investors, including those that were unaccredited.

5 In 1982, the SEC adopted Regulation D as a safe harbor from the registration requirements of the Securities Act. NASD members and their control entities raise capital under Regulation D in MPOs to finance their operations or to pool customer funds to create investment vehicles that provide revenue to the members. MPOs also can be offered privately pursuant to other available exemptions from registration under the Securities Act, such as Section 4(2).

6 NASD Conduct Rules 2710, 2720 and 2810 only govern member participation in *public* offerings of securities.

7 For purposes of quantifying the percent of profits or losses in a partnership attributable to the general partner, NASD will not include performance and management fees earned by the general partner. However, if such performance and management fees are subsequently re-invested in the partnership, thereby increasing the general partner's ownership interest, then such interests would be considered in determining whether the partnership is a control entity.

8 NASD would not issue a "no objections opinion." However, if NASD subsequently determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading, NASD could make further inquiries. The filing requirement also could facilitate the creation of a database on MPO activity that would be used in connection with the member examination process.

9 The MPO sweep revealed that in some cases, offering proceeds were used for individual bonuses, sales contest awards, commissions in excess of 20 percent, or other undisclosed compensation.

10 Members would remain subject to other NASD rules that govern a member's participation in the offer and sale of a security, including Rules 2110, 2120 and Rule 2310. Members also are subject to the anti-fraud provisions of the Securities Act, including Sections 10(b), 11, 12 and 17.

11 Rule 2720 presumes control when there is beneficial ownership of 10 percent of an entity's outstanding voting securities if the entity is a corporation, or in the case of a partnership, more than a 10 percent interest in its distributable profits or losses. *See* Rule 2720(b)(1)(B).

ATTACHMENT A

Proposed Rule Text

2721. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering or MPO

A private placement of unregistered securities issued by a member or a control entity in a transaction exempt from registration under the Securities Act and the filing requirements under Rules 2710, 2720 and 2810.

(2) Control Entity

Any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons. The term "control" for purposes of this Rule means beneficial ownership 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.

(b) Filing Requirements

No member or associated person may offer or sell any security in a Member Private Offering unless the private placement memorandum has been filed with the Corporate Financing Department at or prior to the first time the private placement memorandum is provided to any investor. An amendment or exhibit to the private placement memorandum also must be filed with the Corporate Financing Department within ten days of being provided to any investor.

(c) Disclosure Requirements

No member or associated person may participate in a Member Private Offering unless a private placement memorandum is provided to each investor and the private placement memorandum discloses:

(1) risk factors associated with the investment, including company risks, industry risks and market risks;

(2) intended use of the offering proceeds;

(3) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons; and

(4) any other information necessary to ensure that required information is not misleading.

(d) Use of Offering Proceeds

At least 85 percent of the offering proceeds raised in a Member Private Offering must be used for the business purpose identified in the "intended use of the offering proceeds" disclosure in the private placement memorandum.

(e) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) offerings sold solely to:

(A) institutional accounts (as defined in NASD Rule 3110(c)(4));

(B) qualified purchasers (as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940);

(C) qualified institutional buyers (as defined in SEC Rule 144A);

(D) investment companies (as defined in Rule SEC Rule 144A);

(E) an entity composed exclusively of qualified institutional buyers (as defined in SEC Rule 144A); and

(F) banks (as defined in SEC Rule 144A).

(2) offerings made pursuant to SEC Rule 144A or SEC Regulation S;

(3) offerings in which a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers;

(4) offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act;

(5) offerings of subordinated loans under SEC Rule 15c3-1, Appendix D;

(6) offerings of unregistered investment grade rated debt;

(7) offerings to employees and affiliates of the issuer; and

(8) offerings of securities issued in stock splits and restructuring transactions.

(f) Application for Exemption

Pursuant to the Rule 9600 Series, NASD may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

EXHIBIT 2b

Alphabetical List of Written Comments

1. Timothy P. Selby, Alston & Bird LLP (July 20, 2007)

2. Keith F. Higgins, American Bar Association Committee on Federal Regulation of Securities (July 20, 2007)

3. Todd Anders (July 13, 2007)

4. Neville Golvala, ChoiceTrade (July 19, 2007)

5. Stephen E. Roth, Susan S. Krawczyk, David S. Goldstein, Committee of Annuity Insurers (July 20, 2007)

6. Alan Z. Engel, LEC Investment Corp. (June 14, 2007)

7. Daniel T. McHugh, Lombard Securities Incorporated (July 20, 2007)

8. Dexter B. Johnson, Mallon & Johnson, P.C. (July 19, 2007)

9. John G. Gaine, Managed Funds Association (July 20, 2007)

10. Curtis N. Sorrells, MGL Consulting Corporation (July 20, 2007)

11. Thomas W. Sexton, National Futures Association (July 20, 2007)

12. Michael Sackheim, New York City Bar Committee on Futures and Derivatives Regulation (July 10, 2007)

13. Joseph A. Fillip, Jr., PFG Distribution Company (July 19, 2007)

14. Peter J. Chepucavage, Plexus Consulting (July 20, 2007)

15. Mary Kuan, Securities Industry and Financial Markets Association (July 27, 2007)

16. Bill Keisler, Stephens Inc. (July 20, 2007)

Exhibit 2c

ALSTON&BIRD LLP

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New York, New York 10016

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Timothy P. Selby Timothy.selby@alston.com **(212) 210-9494**

July 20, 2007

VIA E-MAIL [pubcom@nasd.com]

Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, D.C. 20006-1506
Attn: Barbara Z. Sweeney

Re: Notice to Members 07-27 - Member Private Offerings

Dear Ms. Sweeney:

Alston & Bird LLP appreciates the opportunity to provide comments to the National Association of Securities Dealers, Inc. ("NASD") on Notice to Members 07-27 ("Notice 07-27") on proposed NASD Rule 2721 regarding the regulation of Member Private Offerings ("Proposed Rule 2721").

Alston & Bird, founded in 1893, is a major U.S. law firm of more than 750 attorneys with offices in five major U.S. cities, and has an extensive national and international practice. Our Financial Services and Products Group represents major financial services companies, comprising some of the largest U.S. banks and investment firms, a number of which will be adversely impacted if Proposed Rule 2721 is adopted.

We appreciate NASD's intent to protect investors from abuse and fraud in private offerings by NASD members. However, we are concerned that Proposed Rule 2721 is an attempt by the NASD to expand its jurisdictional reach beyond the activities of NASD members. If adopted, Proposed Rule 2721 will subject the affiliates of NASD members to an additional layer of regulation to which they would not be subject but for their affiliated status, placing them at a competitive disadvantage to other alternative investment firms that are not similarly affiliated with an NASD member.

Control Entity Definition

Proposed Rule 2721 should be clarified to ensure that it does not inadvertently apply to new privately-offered alternative investment funds through the "Control Entity" definition. As you know, alternative investment funds are typically organized as limited partnerships, limited liability companies or trusts that are offered privately under Regulation D pursuant to the Securities Act of 1933, as amended. A general partner, managing member or managing owner will be responsible for the overall management of the fund and, as a matter of corporate governance, deemed to control the fund.

In addition, it is common for an affiliate of an NASD member firm to initially make an investment in a new fund and, as a result, it will initially own greater than 50% of the beneficial interest of the fund. Although, Proposed Rule 2721 states that it will not apply to "investment partnerships, direct participation programs, and other private funds that the member might organize," the text of proposed Rule 2721 should explicitly exclude the ownership interest of an affiliated member from the definition of "Control Entity."

Commodity Pool Exemption

Proposed Rule 2721 should explicitly exempt commodity pools from its scope because commodity pools are subject to a pervasive regulatory scheme under the Commodity Exchange Act, administered by the Commodity Futures Exchange Commission ("CFTC") and the National Futures Association ("NFA"). Commodity pools are operated by a commodity pool operator, which must generally be registered as such with the CFTC and be a member of the NFA. Unless otherwise exempt, all commodity pool operators must comply with the CFTC's and NFA's disclosure, reporting and record-keeping requirements.[1] This includes a requirement that all disclosure documents for commodity pools be reviewed and approved by the NFA before their first use. The requirements of Proposed Rule 2721 duplicate those of the CFTC with respect to the content of such disclosure documents. It is worth highlighting that commodity pool operators are also required to provide participants with monthly account statements and a certified annual report. In addition, the NFA conducts oversight examinations of its members, including commodity pool operators.

We believe that in light of the comprehensive regulatory scheme that applies to commodity pools and commodity pool operators, and in order to avoid unnecessary regulatory duplication and potential inconsistent interpretations of similar regulatory requirements, commodity pools should be exempt from the application of Proposed Rule 2721.

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[1] The CFTC exempts from certain of its disclosure and reporting requirements commodity pools which are offered only to specified types of investors, the most common of which is a "qualified purchaser" under the Investment Company Act of 1940, as amended. The NASD also has proposed to exempt offerings to such qualified purchasers under Proposed Rule 2721.

Thank you for this opportunity to comment on Notice 07-27 and Proposed Rule 2721. Please feel free to contact me at (212) 210-9494 if you would like to discuss this matter further.

Sincerely,

Timothy P. Selby

TPS:mwm

LEGAL02/30435919v2

ABA

AMERICAN BAR ASSOCIATION

Defending Liberty
Pursuing Justice

Section of Business Law
321 North Clark Street
Chicago, IL 60610
(312) 988-5000

July 20, 2007

Via E-mail: pubcom@nasd.com

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20036-1506

Re: Proposed Rule 2721 Relating to Member Private Offerings

Dear Ms. Sweeney:

This letter is submitted on behalf of the Committee of Federal Regulation of Securities of the American Bar Association's (the "ABA") Section of Business Law (the "Committee")[1] in response to the request of the National Association of Securities Dealers, Inc. (the "NASD") for comments on the above-referenced rule proposal (the "Proposal"), as published for comment through NASD Notice to Members 07-27 (the "NTM"). This letter was prepared by the Committee's Subcommittee on NASD Corporate Financing Rules.

The comments expressed in this letter represent the views of the Committee only and have not been approved by either the ABA's House of Delegates or Board of Governors, and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committee.

We welcome the opportunity to comment on the Proposal. Capitalized terms used herein are defined in the Proposal, except as otherwise set forth herein.

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[1] References herein to "we" or "our" refer to the Committee.

1. Description of the Proposal

The NASD is proposing for the first time to impose filing, disclosure and use-of-proceeds requirements on a Member Private Offering, which is defined as a "private placement" of "unregistered securities" issued by an NASD member or a "control entity"[2] in a transaction that is exempt from registration under (i) the Securities Act of 1933 (the "Securities Act") and (ii) the filing requirements of NASD Rules 2710, 2720 and 2810 (together, the "Corporate Financing Rules").[3] The Proposal is designed to address problematic practices that the NASD had identified in a "sweep" of NASD member firms. Proposed Rule 2721 would require that the following disclosures be made in a private placement memorandum (a "PPM") relating to a Member Private Offering:

(1) the risk factors associated with the investment, including company risks, industry risks and market risks;
(2) intended use of the offering proceeds;
(3) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons; and
(4) any other information necessary to ensure that required information is not misleading.

In addition, at least 85% of the offering proceeds raised in a Member Private Offering must be used as identified in the "intended use of the offering proceeds" disclosure of the PPM.

A PPM subject to the new rule must be filed with the NASD's Corporate Financing Department (the "Department") at or prior to the first time it is provided to any investor. In addition, any amendment or exhibit to the PPM must be filed with the Department within 10 days of being provided to any investor. According to the Proposal, although the Department will not issue a "no-objections opinion" on the filing, if the NASD subsequently determines that the disclosures in the PPM "appeared to be incomplete, inaccurate or misleading," the NASD could "make further inquiries."

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[2] Pursuant to proposed Rule 2721(a)(2), a "control entity" means any entity that controls or is under common control with an NASD member, or that is controlled by such a member or its associated persons. The term "control" is proposed to be defined for these purposes to mean the "beneficial ownership" of more than 50% of the outstanding "voting securities" of a "corporation," or the right to more than 50% of the distributable profits or losses of a "partnership."

[3] The NASD's Corporate Financing Rules do not apply to, among other things, private offerings by an issuer that are exempt from registration under the Securities Act by reason of Section 4(2) thereunder, including by reason of the safe-harbor exemption set forth in Rule 506 of Regulation D thereunder. *See*, NASD Rule 2710(b)(8)(A) (which also applies to NASD Rule 2810) and NASD Rule 2720(a), including the definition of "public offering" in NASD Rule 2720(b)(14).

2. General Comments

We appreciate the opportunity afforded by the NASD to comment on the Proposal published for comment in the NTM. Although we acknowledge the challenges that the NASD faces in addressing problematic private offerings by NASD members or "control entities," we question whether the imposition of filing and substantive disclosure requirements on all private offerings is the most effective regulatory solution. We believe that the Proposal might impose a compliance burden on NASD members that far exceeds the regulatory benefits to be obtained. Well-publicized enforcement actions, with clear and forceful delineations of the questionable conduct, put members on notice of the unacceptable conduct. A vigorous examination program lets members know that the problematic practices will be subject to scrutiny. Although we recognize that an ad hoc enforcement program can create its own problems, we are concerned that the creation of an entirely new regulatory scheme for private placements may create significant burdens that the Proposal does not appropriately take into account.

a. Additional Scheme of Private Placement Regulation

We believe that the Proposal would inappropriately establish an additional scheme of regulation for private placements that will operate separately from that of the SEC.[4] The NTM expressed concern that some private offerings had not complied with current federal securities law requirements for disclosure in securities offerings. To the extent that Member Private Offerings do not currently comply with the SEC's antifraud and other disclosure standards, we believe that the answer is not for the NASD to adopt its own rules regulating private placements and that, in any event, the new standards proposed by the NASD are unnecessary to facilitate better compliance with the SEC's requirements.

The SEC's rules do not mandate specific disclosures for private placements made solely to accredited investors,[5] nor does the SEC mandate that required disclosures be in the form of a PPM. We do not believe that the NTM sets forth any compelling reason why these requirements should be placed on Member Private Offerings, particularly those made solely to accredited investors. Instead, as previously stated, we believe that the NASD should enforce NASD members' compliance with the federal securities laws applicable to private placements of securities through its NASD member examination program.

b. Scope of NASD Regulation

We are particularly concerned that the Proposal goes significantly beyond the historical scope of NASD regulation – regulating the underwriting terms and arrangements of public offerings of securities, including regulation of conflicts of interest that may occur when an

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4 *See,* our more complete comments on this issue under "Disclosure Requirements" in Part 3.b. below.

5 To the extent a private placement is offered and sold solely to accredited investors, information provided to investors must meet the requirements of the federal antifraud rules and regulations. The NASD's Proposal would not exempt private placements sold solely to accredited investors.

NASD member underwrites a public offering of its own securities or those of an affiliate. The disclosures required by the NASD Corporate Financing Rules are generally limited to matters relating to the fairness of underwriting terms and arrangements, the nature of certain conflicts of interest involving an NASD member, and, in the case of NASD Rule 2810, the suitability standards applicable to an offering of a direct participation program ("DPP"). We note, in particular, that although Rule 2720 (in certain circumstances) and Rule 2810 also require that a member conduct a review of the prospectus or other offering document to ensure that all material facts are adequately and accurately disclosed, these rules do not mandate the kind of broad disclosures of issuer- and offering-related information that the NASD is proposing to adopt in Rule 2721.[6]

The scope of the Proposal would have the NASD reviewing disclosure about a member solely in its capacity as an issuer of securities, not as an agent. As noted above, proposed Rule 2721(c) would permit the NASD to require an issuer to disclose "risk factors associated with the investment, including company risk, industry risks, and market risks" and "any other information necessary to ensure that required information is not misleading." This expansion of scope is dramatic and has the potential to open the door to the NASD conducting a "merit review" of Member Private Offerings. We believe that such a potentially momentous step should only be taken after it is clear that less burdensome alternatives are not effective.

Finally, we would note that the regulatory trend, as evidenced by the recent SEC proposals on capital raising, seems to be moving in favor of reducing the burdens on companies seeking to raise capital. We believe that the Proposal needs to be examined in that light.

c. Scope of the Proposal

Despite the NASD's efforts to limit the Proposal to affiliates that are "control entities" and to exclude certain types of offerings, we also believe that the NASD's Proposal would operate in a manner that would inhibit legitimate private capital-raising activities by well-capitalized NASD members and in the types of offerings by NASD members and their control entities that have not presented issues of compliance with the SEC's private placement rules and regulations nor with the federal antifraud rules and regulations. Although we have some

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[6] NASD Rule 2710(c)(2)(C), for example, requires that all items of underwriting compensation be disclosed in the underwriting section of the prospectus. NASD Rule 2710(h)(2) requires that, subject to certain exceptions, if more than 10% of net offering proceeds will be paid to participating NASD members and/or their affiliates, the underwriting section of the prospectus must disclose that the offering is being made pursuant to the provisions of NASD Rule 2710(h) and, if applicable, set forth the name of the NASD member which is acting as a qualified independent underwriter (the "QIU") and that the QIU is assuming the responsibility of acting as a QIU in the pricing of the offering and conducting due diligence in respect of such offering. NASD Rule 2720(d) requires similar disclosures where an NASD member is participating in an offering of its own securities or those of an "affiliate" or other issuer with which the member has a "conflict of interest," as such terms are defined in NASD Rule 2720. NASD 2810(b)(2)(A) requires disclosure of the suitability standards employed in the offering of any DPP and Rule 2810(b)(3)(ii) requires that a member conduct a review of the prospectus or other offering document to ensure that all material facts are adequately and accurately disclosed and provide a basis for evaluating the DPP.

difficulty ascertaining the various fact situations that have raised regulatory compliance issues in the context of Member Private Offerings, we believe that the principal problematic area has been in the context of a member raising capital for the operation of the member firm or its control entity. In NASD Investor Alert, June 14, 2004, the NASD warned investors regarding NASD member practices with respect to "broker-dealer self-offerings" ("BDOs"), which the NASD described as offerings where a brokerage firm raises private placement capital "to finance their operations or those of an affiliate."[7] In light of the significant compliance burdens imposed by the Proposal, we are concerned that the Proposal is overbroad in reaching to the types of Member Private Offerings that are not of concern to the NASD. Thus, for example, the Proposal would apply to Member Private Offerings by NASD members that are or are affiliated with public reporting companies, whereas problematic Member Private Offerings appear to have occurred only in the case of non-reporting companies. Further, we believe that the Proposal could apply to an NASD member's participation in the sale of 100% of the business of a control entity in the form of corporate stock to a single purchaser because both the investor and the transaction may not qualify for one of the proposed exemptions from the rule.[8] Also, although unintended, the Proposal may be broad enough to reach private offerings by a private investment vehicle sponsored by an NASD member or its affiliate for the purpose of purchasing specific assets, *e.g.*, investments in real estate or securities, such as private DPPs, real estate investment trusts ("REITs"), limited liability companies ("LLCs"), closed-end funds, and other collective investment vehicles (referenced herein together, when appropriate, as "private investment vehicles").

3. Specific Comments on the Proposal

a. Definition of Control Entity

NASD is proposing to define the term "control" for the purposes of the definition of "control entity" in proposed Rule 2721(a)(2) to mean the "beneficial ownership" of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership. In addition to our recommendations to clarify the definition, we are, in general, concerned that this definition is over-broad in its application and would reach situations that do not present the kind of problematic Member Private Offerings that is the basis for the NASD's Proposal.

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[7] NASD Investor Alert dated June 14, 2004 entitled "Brokerage Firm Private Securities Offerings: Buying Your Brokerage" (the "Alert"). The Alert related risks associated with BDO and stated that if an investor participates in such an offering, the investor would "share in the risks that the business will be unsuccessful or unprofitable or you could participate in successful operations of the firm or its affiliates when the increased value of the firm or affiliate's equity is reflected in the value of its securities." The Alert further notes that "[i]nvesting in a private BDO can involve significant risk. And BDOs that are publicized through spam emails or cold calling are often fraudulent or otherwise problematic."

[8] In a sale of a business that was effected by a 100% transfer of stock, the U.S. Supreme Court affirmed in *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (May 28, 1985) that the stock transfer constituted a sale of business that is subject to the protection of the federal securities laws – known as the "sale of business doctrine."

Corporations. A corporation could have multiple classes of stock, such as common stock and preferred stock, each with voting rights attached thereto, although preferred stock may have more limited voting rights. Outstanding debt securities of an issuer may be subject to certain "negative" consent rights that confer voting-type rights on the holders thereof with respect to certain actions by the issuer. We recommend that the definition of control for purposes of determining a "control entity" be clarified to reference "common stock" and "voting power," similar to Nasdaq Rule 4350(i)(1)(D), so that control is based on an ownership of more than "50% of the common stock or 50% of the voting power" of a corporation. We believe that the common stock of a corporation will, generally, be the class of security with the broadest voting rights of any other class of security of such corporation.

Other Legal Entities. The definition of "control" appears to contemplate only issuers that are "corporations" or "partnerships." However, because an issuer may also be, for example, a limited liability company, a business trust, or, if organized offshore, some other form of legal entity, we believe that in the case of an issuer which is not a corporation, the term "control" should mean the right to more than 50% of the distributable profits or losses of any "partnership or other non-corporate legal entity."

Elimination of Common Control Entities. Similar to Rule 2720, the definition of "control" for purposes of determining whether an entity is a "control entity" of a member would encompass "[a]ny entity that controls or is under common control with a member, or that is controlled by a member of its associated persons." Under this definition, a control entity would include an investment vehicle formed by an NASD member's holding company and a member's sister-subsidiary even though the member does not have a controlling interest in the issuer. Although the NASD states in the NTM that Rule 2721 is intended to parallel the protections afforded public investors in Rule 2720, we believe that Rule 2721 is and should be significantly different in scope and application as the NASD clearly intends Rule 2721 to regulate conflicts of interest that arise from offerings of securities in which an NASD member has a continuing self-interest in the operation of the issuer – and not where the conflict of interest relates to the member's role in underwriting an offering of an affiliate's securities.

Therefore, we recommend that the definition of "control" be revised to eliminate its application to common control situations. This recommended change would limit proposed Rule 2721 to "[a]ny entity that controls or is controlled by a member or its associated persons."

Restriction to Parent Entities. Moreover, proposed Rule 2721 would apply to a private offering by a holding company and a remote holding company of an NASD member, even though such holding company is not primarily engaged in the securities business through its subsidiary or down-stream subsidiary broker-dealer. In light of what appears to be the narrow circumstances of brokerage firm fund-raising that the Proposal contemplates, we recommend that the definition of control entity should only apply to a holding company that controls an NASD member if that entity meets the 50% voting control/distributable profits test contained in the Proposal and also meets the definition of being a "parent" in NASD Rule 2720(b)(10), *i.e.*,

derives at least 50% of its gross revenues from the member or employs at least 50% of its assets in such member.[9]

Calculation on a Post-Transaction Basis. Under the Proposal, the determination of whether an issuer is a "control entity" of an NASD member is calculated prior to the transaction. This methodology of calculation would result in the application of the Proposal to a broad range of offerings that do not raise the kind of problematic issues that the NASD intended to address, including to the sale of a business through a stock transaction and to a member's sale of interests in an investment vehicle where the NASD member will retain less than a 50% voting control interest or interest in less than 50% of the profits of the entity after the private placement of securities. For example, the definition of control would encompass, a newly-formed investment vehicle, which, prior to the first closing may be technically wholly-owned, or more than 50% owned, by an NASD member or affiliate of an NASD member. After the completion of the offering, however, the investment vehicle is likely to be more than 50% owned by unaffiliated, third-party investors. We do not believe that the NASD intended to encompass such offerings in the definition of Member Private Offering.

For purposes of NASD Rule 2720, the NASD calculates an NASD member's interest in an issuer on a pre-public offering basis in order to address the conflicts-of-interest that may exist when a member underwrites an offering of an affiliate's securities. In such cases, the NASD will apply Rule 2720 to an offering of securities where a member has a greater-than-10% interest in the securities of an issuer, even though the public offering by the issuer will dilute the member's interest. As previously stated, we believe that Rule 2721 should be significantly different in scope and application than NASD Rule 2720 and should apply only to offerings of securities in which an NASD member has a continuing self-interest in the operation of the issuer. As stated in the Alert, referenced above, the NASD was concerned about offerings where a brokerage firm raises private placement capital "to finance their operations or those of an affiliate."

We believe, therefore, that proposed Rule 2721 should be limited to situations where the investment is in the member itself, in the parent of a member or in a private investment vehicle in which the member or the parent of a member will continue to hold voting control of more than 50% or derive more than 50% of the entity's profits after the closing of the private placement. Therefore, we recommend that the NASD revise the Proposal to calculate the 50% ownership standard on a post-transaction basis for purposes of determining whether a private placement issuer is a "control entity" of an NASD member. Thus, if an issuer forms a reasonable belief that the private investment vehicle will be more than 50% owned by

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[9] References hereafter to a "parent" of an NASD member are meant to encompass only a holding company that beneficially either owns more than 50% of the outstanding voting securities of an NASD member or has the right to more than 50% of the distributable profits or losses of a member that is a partnership, and either derives at least 50% of its gross revenues from the member or employs at least 50% of its assets in the member.

unaffiliated third-party investors after the closing of the private placement, Rule 2721 should not apply to the offering.[10]

Beneficial Ownership Standard. "Beneficial ownership," as used in the definition of "control entity", is not defined. Although endnote 7 to the NTM states that the NASD will not include performance and management fees earned by "the general partner," we believe that the latter is too narrow and seems to, literally, contemplate the receipt of a performance and/or management fee by a general partner of a limited partnership and, thus, would not necessarily encompass the receipt of a management and/or performance fee by managers of other legal entities, such as limited liability companies or offshore entities. We recommend, instead, that the Proposal be revised to include or reference the definition of "beneficial interest" in NASD Rule 2790(i)(1), which specifically provides "[t]he receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, shall not be considered a beneficial interest in the account."

In addition, endnote 7 to the NTM states that if performance and management fees are subsequently re-invested "in the partnership," thereby increasing "the general partner's" ownership interest, then such interests would be considered in determining whether the "partnership is a control entity." The managers of many hedge funds, for example, defer the receipt of their management and/or performance fees for a specified period of time. Because such fees have been earned by the manager, the deferral of the payment of such fees to the manager becomes, or creates, an unsecured obligation of the hedge fund. Typically, the fund, but not the manager, will hedge its obligation by investing the deferred payments in the fund. Because such deferral does not increase the manager's equity "ownership" interest in the fund, we believe that a deferred compensation arrangement, as described above, should not count towards the 50% ownership threshold set forth in the definition of control entity.

b. Disclosure Requirements

Alternative Scheme of Regulation. As set forth above, we are particularly concerned regarding the NASD's proposal in Rule 2721(c) to adopt disclosure requirements for private placement offerings and, in connection therewith, impose a requirement that such disclosures be provided in a PPM, even though the offering may be sold solely to accredited investors. While certain of the items of disclosure are those normally provided in public and private offerings (*i.e.*, risk factors, intended use of offering proceeds, and offering expenses and amount of underwriting compensation), a "catch-all" requirement that would mandate disclosure of "any other information necessary to ensure that required information is not misleading" would significantly expand the disclosure requirements in a manner that cannot be anticipated.

Although the required disclosures appear to track the disclosures generally required under the federal securities laws, we believe that the NASD's enforcement and interpretation of such disclosure requirements will likely create an inconsistent scheme of

[10] Generally, the sponsor of a private investment vehicle retains no more than a 20% equity interest in the vehicle.

regulation with that developed by the SEC and the courts in interpreting the application of the federal securities laws to private placements. For example, the NASD is specifically mandating risk factor disclosure, specifying that such disclosure must pertain to company, industry and market risks. It is clear that the NASD will interpret what types of disclosure are appropriate in each private placement, depending on the facts and circumstances. We also note that the proposed requirement for disclosure of "market risks" may be intended by the NASD to require disclosure of the illiquidity of private placement securities. However, the NASD's requirement is likely to establish a different standard for disclosure than that contained in Regulation D, which requires that the securities be restricted from resale and that "written disclosure [be provided] 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."[11] In addition, in the case of offerings sold entirely to accredited investors, the extent of the issuer's offering disclosure may be affected by the level of due diligence being conducted by potential investors. Thus, the private placement documents specifically prepared for investors may not, in fact, reflect the entire information provided to and obtained by potential investors. We are concerned that the NASD, as an enforcement matter, may not consider the complete scope of the information provided to or obtained by investors in assessing whether the offering complies with the NASD's proposed disclosure standards.

Disclosure Requirements are Unnecessary. As discussed previously, since the disclosure requirements generally appear intended to ensure compliance with the federal securities law standards, we believe that none of these separate standards are necessary or appropriate to be adopted by the NASD and that, instead, the NASD should conduct its review of Member Private Offerings through its examination program.

Mandate for a PPM. As previously mentioned, the Proposal would require the filing of and certain disclosures in a PPM. A formal PPM is not mandatory for private placements. In some cases, the issuer will provide a term sheet and other relevant documents to potential investors and investors will also obtain relevant information through their own due diligence. We are concerned that the Proposal represents the first instance of a federal requirement for a form of disclosure document for a private placement.

Definition of "Participation." In addition, proposed Rule 2721(c) would require that no NASD member or associated person may "participate" in a Member Private Offering unless a PPM, meeting certain mandated disclosure requirements, is provided to each investor. The term "participate" is not defined and we seek clarification as to whether the NASD intends to employ the definition of "participation" set forth in NASD Rule 2710(a)(5), which definition encompasses not just marketing, but also, among other things, "[p]articipation in the preparation of the offering or other documents" and "in any advisory or consulting capacity to the issuer related to the offering." We believe that the concept of participation for purposes of Rule 2721 should be considerably narrower than that in Rule 2710(a)(5) and should only encompass

[11] SEC Rule 502(d)(2).

situations where an NASD member is acting in a distributing or selling capacity (subject to the exemptions discussed below, including the exemption for sales through another NASD member).

Application of the Rule to the "Relevant NASD Member." Further, the structure of proposed Rules 2721(b) and (c), and the exemption provided in Rule 2721(e)(3) raise the important issue of whether the NASD only intends the proposed rule to apply in the case of qualifying private placements in which the relevant NASD member[12] participates in a sales capacity or whether the NASD intends the rule to apply to any issuance by an NASD member or its control entity regardless of the relevant member's participation. The latter application of Rule 2721 would be more expansive than that of Rule 2720, which only applies in cases where the relevant member is participating in the offering, even if the member is issuing its own securities.

We urge the NASD (if it proceeds with the Proposal) to revise proposed Rule 2721 to make clear that the requirements in proposed Rules 2721(b) - (d) apply only in the case of a Member Private Offering if the relevant NASD member participates in the distribution of the securities. Thus, proposed Rule 2721 should not apply to a Member Private Offering if the issuer sells its securities through an unaffiliated NASD member. Such other NASD member, acting as placement agent for the Member Private Offering, will serve as an objective arbiter of the adequacy of the disclosure to prospective investors as well of the proposed business terms, such as the proposed use of proceeds of the offering.

In order to so limit the Proposal, we recommend that an introduction be added to proposed Rule 2721 indicating that the "The following requirements apply to an NASD member that participates in a sales capacity in a Member Private Offering of equity securities issued or to be issued by the member, the parent of the member, or other control entity of the member." This revision, and other changes to the substantive provisions, would address the apparent inconsistencies in the application of the requirements of Rules 2721(b) – (d) and ensure that they are only applicable to the relevant NASD member that participates in a selling capacity in a Member Private Offering of securities issued by an NASD member or by a control entity of a NASD member (subject to the exemptions provided in the rule).

c. Filing Requirement

Proposed Rule 2721(b) would prohibit an NASD member or associated person from offering or selling any security in a Member Private Offering, unless the applicable PPM has been filed with the Department at or prior to the first time the PPM is provided to any investor. In addition, any "amendment or exhibit" to such PPM must also be filed with the Department within 10 days of being provided to any investor.

Compliance Difficulties. We believe that there are considerable practical problems in complying with the NASD's proposed filing requirements and that, in general, the

[12] For purposes of this discussion, we will use the term "relevant NASD member" to refer to the member that is the issuer of the securities or in a control relationship with a "control entity" that is the issuer of the securities.

burdens imposed by the filing requirements far outweigh the intended benefits. Moreover, as set forth above, we believe that the NASD's purposes can be better achieved through the member examination program. As previously discussed, the filing requirement assumes the preparation of a formal PPM, whereas, in some cases, only a term sheet and other documents may be provided to investors. Further, many private placements involve a process of negotiation with potential investors and the terms are only finalized at the point of investment.. It is unclear how the proposed filing requirements would apply in these situations. Further, any filing requirement should not reach to amendments or exhibits, as these documents can be requested by NASD staff if necessary, and the filing of such documents would, in any case, be overbroad in possibly encompassing the types of sales literature and supplemental materials that would not be subject to filing with the Department in the context of a public offering.

NASD Action After Filing. The NASD NTM is also clear that the NASD will review filed Member Private Offerings for compliance with the federal antifraud rules and regulations, as well as the NASD's proposed disclosure requirements. Although the Proposal states that the NASD will not issue any form of "no-objections opinion" in connection with a filing under proposed NASD Rule 2721, the NASD states that it may make "further inquiries" if, "subsequently," the NASD has "determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading."[13] Once the NASD asserts its jurisdiction through a specific rule to conduct a review of Member Private Offerings, we believe that the lack of an NASD form of "clearance letter" creates an untenable regulatory compliance situation for the issuer and NASD members that conduct a Member Private Offering because of the potential liability concerns if the NASD were to subsequently determine that any of the disclosures in the PPM were "incomplete, inaccurate or misleading." Under these circumstances, we believe that the lack of a clearance letter will discourage issuers and NASD members from undertaking legitimate private placement capital-raising. In a similar situation involving NASD member advertising for mutual funds that are subject to filing with the NASD under Rule 2210, NASD members generally will not commence use of such advertisements until they receive a clearance letter from the NASD's Advertising Department even through permitted to do so.[14]

Confidentiality. Endnote 8 to the Proposal states that the NASD may create a "database of MPO activity." Because of the proprietary and sensitive nature of information that may be set forth in any PPM, amendment, or exhibit, that is required to be filed with the Department under the proposed Rule 2721, we believe, by analogy to NASD Rule 2710(b)(3), that the NASD should specifically provide that the NASD shall accord confidential treatment to all documents and information filed with the Department pursuant to proposed Rule 2721, and that the NASD shall utilize such documents and information solely for the purpose of review to determine compliance with the requirements of such proposed rule.[15]

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[13] We also believe it likely that NASD staff will review whether a Member Private Offering complies with the claim of exemption from registration under the Securities Act.

[14] In comparison, for example, an issuer will file a Rule 424 prospectus for a public offering with the SEC and will go forward with the offering because such a filing is subject to a "no review" policy.

[15] In addition, the broad availability of such information could interfere with an issuer's obligation to control

d. Use of Offering Proceeds

Proposed Rule 2721(d) would require that at least 85% of the offering proceeds of a Member Private Offering be used for the business purposes identified in the PPM. The NASD notes in the NTM, that this requirement is "consistent with the [15%] limitation of offering fees and expenses, including compensation, in NASD Rule 2810. " We disagree that the proposed limitation in Rule 2721 on the use of offering proceeds is the same as or consistent with the 15% limitation on organization and offering expenses ("O&O") in NASD Rule 2810. The proposed 85% use-of-proceeds limitation is, we believe, intended to address potential misappropriations of offering proceeds rather than control the amount of O&O expenses. While an issuer may use offering proceeds for purposes that are not consistent with the intended use of proceeds disclosed to investors, we believe that redress is to the federal antifraud rules. Those rules make it clear that offering proceeds must be used for the purposes disclosed to investors and, therefore, it is neither necessary nor appropriate for the NASD to adopt such a requirement.

In any event, we are certain the NASD was limiting the amount of O&O expenses paid from proceeds of the offering, and did not intend to impose a 15% or any other limitation on the total amount of offering fees and expenses. Although the language in the Proposal does not impose such an overall limitation, the language in the NTM if taken out of context could be misinterpreted to that effect, and we suggest tightening up the language of the NTM to avoid such misinterpretation. In addition to the context, we are certain that the NASD did not intend to impose an overall cap on O&O expenses for several reasons. First, private offerings conducted in accordance with Section 4(2) of the Securities Act and/or Rule 506 thereunder are necessarily offered only to sophisticated investors who can negotiate their own terms and appropriately "fend for themselves." In addition, the NASD is not proposing through Rule 2721 to limit or establish the fairness of "underwriting compensation," but rather to ensure that up-front costs to investors do not exceed 15% of the investment.

We agree that the NASD has historically limited total O&O expenses of DPP and REIT offerings by issuers that are affiliated with a distributing NASD member to 15%, which standard seeks to regulate the aggregate amount of underwriting compensation and the total amount of issuer-only expenses paid from offering proceeds. However, unlike Rule 2810, Rule 2721 is seeking only to address misuse of offering proceeds; hence, clearly the 15% calculation should not include any part of the placement agent's compensation (including cash, expense reimbursements and securities) that is paid from a source other than the proceeds of the offering, and should not include any trail commission paid by a closed-end fund, DPP or REIT because such payments are an operational expense of the private investment vehicle that does not reduce the invested offering proceed.[16]

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the dissemination of offering materials and not engage in general advertising or general solicitation**.** *See*, Rule 502(c) under the Securities Act.

[16] Moreover, trail commissions should not be deducted from the 85% calculation of the use-of-proceeds.

e. Exemptions

Proposed Rule 2721(a) states that the rule is intended to apply to "[a] private placement of unregistered securities . . . exempt from registration under the Securities Act and the filing requirements under Rules 2710, 2720 and 2810." Proposed Rule 2721(e) includes a number of exemptions from proposed Rule 2721 for offerings sold to certain types of investors and for certain types of offerings.

Scope of "Private Placement." Because certain offerings that are exempt from registration under the Securities Act and filing with the NASD under the Corporate Financing Rules are nonetheless public offerings, it is unclear what the intended scope is of the term "private placement." Further, the NASD's reference to such offerings being "exempt from the filing requirements under the Rules 2710, 2720, and 2810" is confusing, since offerings exempted under NASD Rule 2710(b)(7) are "public offerings" that remain subject to the substantive requirements of Rule 2710. Effectively, a private placement should only encompass those offerings of securities that are made in reliance on an SEC private placement exemption or that are treated like a private placement. Therefore, we recommend that the NASD Rule 2721 should include a definition of "private placement" for purposes of Rule 2721 and should define the term as offerings conducted in reliance on Sections 4(2) or 4(6) of the Securities Act, or SEC Rule 504 if the securities are "restricted securities" under SEC Rule 144(a)(3), or Rule 505 or Rule 506 adopted under the Securities Act, except offerings of exempted securities as defined in Section 3(a)(12) of the Exchange Act.[17]

Public Issuer Exemption. The major focus of the NASD Alert and the NTM appears to be on the inadequacy of disclosures by non-public companies that conduct private placements. We believe that the problematic types of private placements that are of concern to the NASD are not likely to occur in the case of private placements by a company that is itself a reporting company under the Exchange Act or is related to such a reporting company. Therefore, we strongly recommend that the Proposal be revised to exempt a Member Private Offering, including those of a non-reporting control entity, if the NASD Member, a holding company of the NASD member, or the issuer of the securities is a reporting company under Sections 12 or 15(d) of the Exchange Act. The rationale for extending this recommended exemption to any holding company of an NASD member, rather than to only the member's parent, is that the public disclosure requirements applicable to the holding company will encompass the member and any of its affiliates that are consolidated on the holding company's financial statements.

Limitation to Equity Offerings. We also recommend that the Proposal be revised to only apply to the issuance of an equity security, as defined in Section 3(a)(11) of the Securities Act, and that the definition should include the exemptions provided in NASD Rule 2790(i)(9)(B) – (J) (which may also be discussed separately below). Although the NASD proposed to exempt investment grade rated debt, we do not believe that the exemption from Rule 2721 should have the same scope as that contained in Rule 2720. Debt securities are an obligation of the issuer to

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[17] *See*, Rule 2710(b)(8)(A) and Rule 2720(a)(14).

pay interest on a fixed schedule and to return principal by a fixed date. We believe that the problematic issues identified by the NASD with respect to BDOs are likely to have occurred in the context of equity offerings and not in the issuance of debt securities. Thus, we believe that the Proposal should be revised to only apply to equity securities, thereby obviating the need to establish a long list of exempted categories of non-equity securities.

Offerings to Accredited Investors. The Proposal would not exempt a Member Private Offering that is sold to even one accredited investor, even though the rest of the offering may be sold to the categories of investors included in proposed Rule 2721(e)(1)(A) – (F). These referenced exemptions are only available if sales are made "solely" to such types of investors, including institutional accounts, qualified purchasers, qualified institutional buyers, investment companies and banks. We believe that sales to investors meeting such standards also should encompass any accredited investors participating in the Member Private Offering. Therefore, we recommend that the NASD amend the introduction to Rule 2721(e)(1) to provide an exemption from the rule if a majority of the interests sold in the offering are sold to investors that are reasonably believed to meet the requirements for any of the exempt categories of investors. We also recommend that the exemption under Rule 2721(e)(2) for "offerings made pursuant to SEC Rule 144A or SEC Regulation S" be revised to be available in the case of offerings of securities that qualify under Rule 144A that are made to qualified institutional buyers ("QIBs") meeting the requirements of Rule 144A(a)(1), to non-U.S. persons under Regulation S, and to accredited investors under Regulation D.

Categories of Investors. The categories of investors in proposed Rule 2721(e)(1)(C) – (E) include investment companies, an entity composed exclusively of qualified institutional buyers and banks as defined in SEC Rule 144A. We believe that these categories of investors are confusing as the definition of qualified institutional buyer in Rule 144A(a)(1) encompasses those categories of investors, and others, *e.g.*, savings and loan associations, forms of trusts, investment advisers, and employee benefit plans. Thus, we believe that subprovisions (C), (D) and (E) are unnecessary. In addition, we believe that the investor categories should include an insurance company as defined in Section 2(a)(13) of the Securities Act.

Offerings Through Other Broker-Dealers. Proposed Rule 2721(e)(3) would exempt a private placement in which "a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers." Since private placement offerings are not generally purchased on a principal basis, we recommend that this exemption be revised to apply to offerings that are sold "through," rather than "to," other unaffiliated broker-dealers."[18]

Offerings to Employees and Affiliates of the Issuer. Proposed Rule 2721(e)(7) would exempt a private placement made to "employees and affiliates of the issuer." We believe that the term "affiliates" would only include legal entities and not natural persons. Further, we

[18] As recommended above, we believe that proposed Rule 2721 should not apply to a Member Private Placement unless the relevant member is participating in sales in connection with the offering. Thus, this exemption would only be necessary where the relevant NASD member is participating in a wholesaling capacity, but is selling through an unaffiliated NASD member or members.

believe that this exemption is overly narrow in not including directors and the immediate family of any such permissible persons. We recommend, therefore, that this exemption be clarified and expanded to include directors and employees and anticipated directors and employees (*e.g.*, a new chief executive officer), and their immediate family, as follows: "offerings to any affiliate of the issuer and to any current or anticipated employee or director of the issuer and of any affiliate, and the immediate family of such persons."

Other Exemptions. In addition, we believe that the following categories of offerings should also be exempt from the application of the Proposal as they do not represent that type of problematic capital-raising contemplated by the NASD in endnote 3 to the NTM and in the Alert:

- Offerings of equity derivatives, such as over-the-counter ("OTC") options, which are derivative of, or based upon, a security issued by an unaffiliated issuer. In an equity derivative transaction, the seller of the equity derivative, such as an OTC option, could be deemed to be the "issuer" of such option, although such issuer is not the issuer of the underlying security upon which the equity derivative is economically based.

- Offerings of structured notes and asset-backed (financing instrument-backed) securities.

- Financial products offered by state or federal-regulated bank affiliate of an NASD member, as these offerings are specialized products that are designed, and intended, for specialized and sophisticated investors.

- Offerings of a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code, which are currently exempted from the NASD's conflict –of-interest rules in Rule 2710(h) and Rule 2720.

- Offerings of a "direct participation program" as defined in Rule 2810, which are also currently exempted from the NASD's conflict-of-interest rules.

- Offerings of commodity pools, which are operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act.

- Exchange offers.

- Offerings of securities exempt from registration under Section 3(a)(4) of the Securities Act.

f. Implementation and Compliance

Implementation of the Rule. We request that the NASD clarify that it will not apply proposed Rule 2721 to any offering that commenced prior to the effective date of such rule

and that the effective date will not be earlier than 90 days after the date of the publication of an NASD Notice to Members announcing adoption of the amendments.

Filing Methodology. The NTM does not address the manner in which the NASD is proposing to require that NASD members file private offering materials with the NASD. The NASD requires that NASD members and their counsel submit filings of public offerings for review by the Department via the COBRADesk system pursuant to the NASD's underwriting rules. COBRADesk is an Internet-accessed system that requires that each filing firm have a COBRADesk manager, that each user obtain a password, which password must be updated every six months, and that each user learn how to complete the COBRADesk templates for information submission. Although private placement materials could be submitted via COBRADesk and we anticipate that only minimal identifying information would be required to be input to the system, we believe that the burdens of using the COBRADesk system on NASD members and their counsel who do not usually submit public filings to the Department would be excessive. For example, the need to update a password every six months will effectively require many filers to get a new password every time a filing is to be made, as such filings are likely to be infrequent.

Therefore, we recommend that the NASD allow NASD members and their counsel to submit Member Private Placements via email to a specific email address established for that purpose in the form of either a Word or PDF document. To the extent that the issuer prepares a formal PPM, a Word or PDF version of the PPM can be submitted via email to the NASD via email. In the case of private offering materials that are provided to investors along with or in lieu of a PPM, such materials can be saved as a PDF file by the sender and also forwarded via email to the NASD. We also recommend that each such submission trigger an automatic response email from the NASD, which attaches the sent email and its attachments and acknowledges receipt of the filing. Thus, the submitting NASD member and its counsel will have a document that includes the date, time and documents submitted for purposes of maintaining a record in their files of the NASD member's compliance with the filing requirements of proposed Rule 2721.

* * *

We hope that these comments will be helpful to the NASD in its consideration of the Proposal. Due to the extensive nature of its concerns regarding the Proposal, the NASD Corporate Financing Subcommittee would be pleased to discuss any aspect of these comments with the staff of the NASD. Questions may be directed to Suzanne E. Rothwell at (202) 371-7216 or David M. Katz at (212) 839-7386.

Respectfully submitted,

/s/ Keith F. Higgins

Keith F. Higgins, Chair
Committee on Federal Regulation of Securities

Drafting Committee:

Suzanne E. Rothwell
David M. Katz
Peter W. LaVigne
Ellen Lieberman
Hugh Makens

July 13, 2007

Comments on proposed rule:

- Written "PPMs" are not appropriate in every deal. With institutional investors, they often want to see a PowerPoint and move quickly to their own due diligence.
- If written PPMs are mandated, they should be limited to deals that are being shown to the investing public (i.e. non-institutional and non-corporate)
- If the requirement is passed, it should be limited to equity raises and specifically should exclude senior debt (taking a PPM to a bank or other specially lending institution makes no sense).
- An institutional capital raise exclusion is essential, as neither industry practice nor the needs/desires of the investors/lenders are protected/served buy creating formal disclosures where the investor is sophisticated and has access to company information through the due diligence process.
- The pre-filing requirements are unduly burdensome and will hinder capital raises for clients that need to approach the market quickly
- Filing and review of PPMs is likely to create an unnecessary strain on and bureaucracy at the NASD that will inhibit members ability to do business

Todd Anders

July 19, 2007

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
Washington, D.C.

Dear Ms. Sweeney,

The following comments are submitted in response to NTM 07-27 ("Notice").

I wish to voice my serious objection to the rule in its currently proposed form.

I suggest that all members be informed by the NASD as to exactly what percentage of the total membership was targeted in enforcement actions regarding private securities of members in the past twelve months, and a summary of the outcome of each case. This would help indicate whether a new rule, one that places additional filing and audit burdens on the entire membership, is necessary. The NASD should also provide a reasonable estimate of the cost of the additional filing and audit burden. It appears to this commentor, after reading the Notice, that the percentage of firms engaging in potential violations of this nature was very small, indeed, only a tiny fraction of the entire membership.

In general, we, as an organization, both regulator and regulated, have to resist the urge to make a new rule, each time a tiny percentage of the membership engages in potentially violative activity. In an open and free society, one can never prevent a small group of citizens from violating rules. No matter how far-reaching and intelligent our rule makers and enforcement officials may be, a few people will always be able to slip through the cracks. Indeed, if they have found a way to violate the current rule, you may be relatively certain they will find a way to violate the new rule.

Good regulation is not about preventing every violation; it is about sound response. In the aftermath of the September 11th terrorist attacks, the U.S. targeted Afghanistan, not all Muslim countries. Did we bomb Germany because one terrorist lived there for a period of time? If a few firms violate the law, by all means punish them for this. To put a new rule in place, one that places a burden on all firms engaging in the issuance of private securities, is not, in the opinion of this commentor, a wise use of the NASD's or the industry's resources.

Specifically:

- If a member is not in the business of conducting private placements for issuers, and conducts only private placements of its own securities from time to time, this is purely a corporate matter of the member, and the offering should be entirely exempt from the requirements of the rule.

- If a member issues its private securities only to accredited investors and specifically excludes non-accredited investors from its private placement, the offering should be entirely exempt from the requirements of the rule. Accredited investors are capable of reviewing PPMs and other due diligence material and are considered savvy enough to make their own decisions. Despite the spectacular falls of many hedge funds in recent years, there is no regulation of this segment of the industry because they accept investment from only accredited investors (even though the reality is that behind many of the pension funds that invest in hedge funds, there are millions of investors who are not accredited).

- Where as I strongly support the idea that at least 85% of investment should be used in the business, I don't believe the NASD should carve this into a rule. There may be situations where savvy, accredited investors see an opportunity for high return in an offering where the sales remuneration or other "not in the business" expenses are greater than 15%. They would be forced to pass on the opportunity under the new rule (as proposed). Indeed, in the hedge fund world, the standard fee is a small percentage of assets, in the 1%-2% range, plus 20% of profits. Yet, some managers command a higher fee and upto 50% of profits. We live in a free economy -- if an accredited investor wants to pay a commission of 20% or

more in the hope of a high return, there should not be a rule that would stop them from doing so.

- I am opposed to the filing requirement, both initial and subsequent, of the proposed rule, as well as the requirement to make a PPM part of a member audit. I see no productive purpose in burdening compliant members with these additional burdens.

- If the rule is ultimately passed, I support one that is narrowly confined to offerings that may possibly include non-accredited investors. These investors may not be savvy enough to make their own investment decisions, and potentially need some protection.

Very truly yours,

Neville Golvala
CEO
ChoiceTrade

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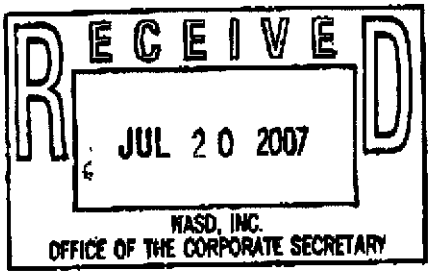
July 20, 2007



VIA MESSENGER

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: NASD Notice to Members 07-27; Proposed Conduct Rule 2721

Dear Ms. Sweeney:

Our firm represents the Committee of Annuity Insurers (the "Committee").[1] We respectfully submit this letter of comment on behalf of the Committee regarding new Conduct Rule 2721 proposed by NASD in Notice to Members 07-27 (June 2007) ("NtM 07-27").

Proposed new Conduct Rule 2721 (the "Proposed Rule") would establish disclosure and filing requirements as well as limits on offering expenses for private placements (*i.e.*, non-public offerings) of securities issued by NASD members or their affiliates that come within the definition of a "control entity" in the Proposed Rule (hereinafter, "Member Private Offerings" or "MPOs"). The Committee does not believe that the Proposed Rule is intended to apply, and believes that it should not apply, to the offer and sale by an NASD member of variable annuity contracts, variable life insurance policies, modified guaranteed annuity contracts, or modified guaranteed life insurance policies issued by an insurance company that is a control entity of the NASD member.[2] Therefore, the Committee recommends the changes to the Proposed Rule discussed below that would specifically exempt offers of Subject Contracts from the Rule's requirements.

The Proposed Rule

The Proposed Rule would impose the following requirements on Member Private Offerings:

[1] The Committee of Annuity Insurers is a coalition of life insurance companies that issue fixed and variable annuities. The Committee was formed in 1981 to participate in the development of federal securities law regulation and federal tax policy affecting annuities. The member companies of the Committee represent over half of the annuity business in the United States. A list of the Committee's member companies is attached as an Appendix.

[2] Variable annuity contracts and variable life insurance policies are together defined as "Variable Contracts" by NASD Conduct Rule 2820(b)(1). Modified guaranteed annuity contracts and modified guaranteed life insurance policies are identified in NASD Conduct Rule 2710(b)(8)(E). For purposes of this letter, we refer collectively to Variable Contracts, modified guaranteed annuity contracts, and modified guaranteed life insurance policies as "Subject Contracts".

- Delivery of a private placement memorandum ("PPM") to each investor with information regarding risk factors, intended use of proceeds, offering expenses and any other information necessary to ensure that required information is not misleading;
- Filing of the PPM with NASD's Corporate Financing Department at or prior to the time it is provided to any investor; and
- At least 85% of the offering proceeds be used for the business purposes identified under "use of proceeds" disclosure in the PPM.

According to NtM 07-27, the Proposed Rule is a result of widespread abuses NASD has observed in recent years with certain MPOs, a number of which have been the basis of enforcement actions against offending members.[3] Among the abuses observed by NASD was the failure to provide a PPM to non-accredited investors in MPOs relying on Regulation D under the Securities Act of 1933 (the "1933 Act") and misleading, incorrect, or selective disclosures in PPMs that were provided to investors, including omissions and misrepresentations regarding selling compensation and the use of offering proceeds.[4]

As explained in NtM 07-27, MPOs are non-public offerings of securities not registered under the 1933 Act.[5] Typically, MPOs rely on the exemption from the registration and prospectus delivery requirements of the 1933 Act available under Section 4(2) of that Act and Regulation D thereunder.[6] According to NtM 07-27, NASD members and their control entities use MPOs to raise capital to finance their operations or to pool customer funds to create investment vehicles that provide revenue to the members.[7]

The Proposed Rule is intended to provide investor protections with respect to MPOs that are parallel, though not identical, to the protections provided by NASD Conduct Rule 2720 in connection with member public offerings.[8] Rule 2720 was designed to protect investors in member public offerings from potential abuses arising as a result of the conflicts between the interests of a member's customers and those of the member or its control entities inherent in the offering of its own securities or those of its control entities to its customers.[9] Thus, the Proposed

[3] NtM 07-27, note 3 and accompanying text.

[4] NtM 07-27, note 4 and accompanying text.

[5] NtM 07-27, note 5 and accompanying text.

[6] NtM 07-27, note 5. MPOs also may rely on other exemptions from the registration and prospectus delivery requirements of the 1933 Act.

[7] NtM 07-27, note 5.

[8] NtM 07-27, text accompanying note 10.

[9] *See* NASD Notice to Members, Proposed Amendments to By-Laws and Rules of Fair Practice (Interpretations) Governing the Distribution of Securities of Members (May 8, 1971).

Rule is designed to protect a member's customers from conflicts of interest that may arise between the customer and the member or its control entities as a result of an MPO.

Under the Proposed Rule, MPOs would include offerings by an entity that is under common control with the member, or that the member firm or its associated persons control. "Control" under the Proposed Rule would be defined as beneficial ownership of (1) more than 50% of the outstanding voting securities if the entity is a corporation, or (2) in the case of a partnership, more than a 50% interest in the partnership's distributable profits or losses. As a result, the Proposed Rule would not apply to MPOs by an entity that does not meet this test, including investment partnerships, direct participation programs and other private funds that the member might organize but in which the member, its associated persons, or any parent of the member does not beneficially own the requisite positions.[10]

Applicability of the Proposed Rule to Subject Contracts

It is not clear from the Proposed Rule and NtM 07-27 whether or not NASD intends the Proposed Rule to apply to Subject Contracts. The purpose of the Proposed Rule suggests that it is not targeted at member offerings of Subject Contracts issued by control entity insurance companies. Nonetheless, the definition of MPO in paragraph (a)(1) of the Proposed Rule appears to include such offerings. Paragraph (a)(1) defines an MPO as "[A] private placement of unregistered securities issued by a member or a control entity in a transaction exempt from registration under the Securities Act and the filing requirements under Rules 2710, 2720, and 2810." Subject Contracts may be offered and sold in transactions exempt from the 1933 Act, such as a non-public offering pursuant to Section 4(2) of the 1933 Act or Regulation D thereunder, and are exempt from the filing requirements of NASD Conduct Rules 2710, 2720 and 2810.[11]

The Committee believes that the public policy reasons for adopting the Proposed Rule are laudable, but that its purpose would not be served by applying the Proposed Rule to Subject Contracts. Therefore, regardless of NASD's intent, for the reasons expressed below, the Committee strongly urges NASD to exempt member offers of Subject Contracts from the Proposed Rule.

The purpose of the Proposed Rule is to address abuses observed by NASD in MPOs. NtM 07-27 cites a number of enforcement actions NASD has taken against members for such abuses. None of the cited enforcement actions relate in any way to the offer or sale of a Subject Contract. This is not surprising because the conflicts of interest inherent in many MPOs do not arise in connection with the offer and sale of Subject Contracts by a member that are issued by a

[10] NtM 07-27, page 5.

[11] NASD Conduct Rule 2710(b)(D) exempts Variable Contracts, and Rule 2710(b)(E) exempts modified guaranteed annuity contracts and modified guaranteed life insurance policies, from the filing requirements of Rules 2710, 2720, and 2810.

control entity insurance company. Unlike securities sold to obtain financing for the issuer, Subject Contracts are issued by insurance companies and sold by their affiliated underwriters in the ordinary course of their business. The "proceeds" from the sale of such contracts are used primarily for the benefit of the owner of the contract, and only a small portion of the proceeds directly benefits the issuer. As a result, the interests of the issuing insurance company and its affiliated member do not generally conflict with the interests of prospective owners of Subject Contracts. In this regard, the offer and sale of a Subject Contract in an MPO is not materially different than the sale of such a Contract by a member in a registered public offering.

The Committee maintains that the potential for overreaching, providing deficient disclosure documents (or failing to provide disclosure documents) or otherwise misleading prospective investors, and misusing proceeds, are no greater when Subject Contracts issued by a control entity of a member are offered and sold in an MPO than when such Contracts are offered and sold in a registered public offering. The Committee observes that, for largely the same reasons expressed above, Subject Contracts offered in a registered public offering are exempted from NASD Rule 2720, the public offering analog of the Proposed Rule.[12] Consequently, the Committee believes that no useful public policy would be served by applying the conditions of the Proposed Rule to the offer and sale of Subject Contracts in an MPO and that the Proposed Rule should exempt offerings of Subject Contracts from its coverage.

Recommended Changes to the Proposed Rule

To make clear that the Proposed Rule does not apply to Subject Contracts offered or sold by NASD members, the Committee respectfully recommends adding two exemptions to paragraph (e) of the Proposed Rule.[13] The exemptions provisions would read as follows:

> (9) offerings of variable contracts (as defined in NASD Rule 2820(b)(1)); and
>
> (10) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies (as referenced in NASD Rule 2710(b)(8)(E)).

Securities Exempted by Section 3(a)(12) of the Act

From time to time, members may offer and sell Subject Contracts issued as "exempted securities" within the meaning of Section 3(a)(12) of the Securities Exchange Act of 1934 ("Exempted Securities"). Exempted Securities, including those in the form of Subject Contracts,

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[12] *See, e.g.*, Securities Exchange Act Release Number 35435 (March 9, 1995).

[13] The Committee notes that in identifying the range of insurance products over which a *Limited Principal – Investment Company and Variable Contracts Products* may function in a principal capacity, Conduct Rule 1022(d)(1)(A)(iii) references all contracts issued by an insurance company that are securities. Therefore, in lieu of the exemptions proposed above, the Proposed Rule could exempt "offerings of variable contracts, insurance premium funding programs, and other contracts issued by insurance companies (as referenced in NASD Rule 1022(d)(1)(A)(iii))."

are offered and sold pursuant to the exemption from the registration and prospectus delivery requirements of the 1933 Act provided by Section 3(a)(2) of that Act. Because NtM 07-27 does not mention adding the Proposed Rule to the list of NASD Conduct Rules and Interpretive Materials that apply to Exempted Securities found in Rule 0116 (the "Rule 0116 List"), the Committee assumes that the Proposed Rule would not apply to Exempted Securities. However, in the event that such an assumption is not correct, the Committee wishes to express its strong belief that, for the same reasons that Conduct Rule 2720 is not included in the Rule 0116 List, the Proposed Rule should not be added to the List.

Conclusion

The Committee appreciates the time and resources that NASD and its staff have devoted to the Proposed Rule. We are pleased to have this opportunity to provide comments to NASD, and we appreciate NASD staff's careful consideration of the Committee's recommendations.

Respectfully Submitted,

SUTHERLAND ASBILL & BRENNAN LLP

By: Sutherland Asbill & Brennan LLP
Stephen E. Roth
Susan S. Krawczyk
David S. Goldstein

APPENDIX

Committee of Annuity Insurers

AEGON USA, Inc.
Allstate Financial
AIG American General
AmerUs Annuity Group Co.
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
Conseco, Inc.
F & G Life Insurance
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
Merrill Lynch Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
(an Ameriprise Financial company)
Sun Life of Canada (U.S.)
The Phoenix Life Insurance Company
USAA Life Insurance Company

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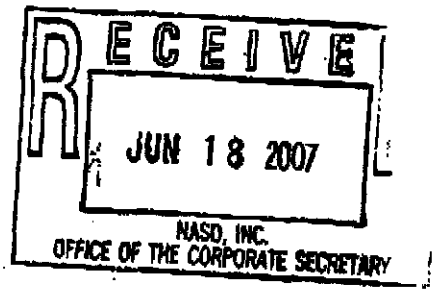

June 14, 2007

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Dear Ms. Sweeney:

We wish to comment on that part of Proposed Rule 2721 that sets forth the test of whether a member's affiliated issuer that is a partnership is a "control entity." Under Proposed Rule 2721, a partnership would be a control entity of a member if that partnership controls, is controlled by or is under common control with a member or its associated persons. Because control is defined to mean the right to more than 50 percent of the distributable profits or losses of partnership, a member would be deemed to be under common control with an issuer partnership if associated persons of a member have a right to more than 50 percent of that partnership's profits or losses. We submit that the test is problematic if it is applied at the OUTSET of an offering - as opposed to the completion of an offering.

We are a small firm that only participates in offerings of real estate development partnerships formed by our associated persons. Our clients are strictly accredited investors who have profited handsomely from participating in our developments. Our partnerships typically are organized so that, through an affiliate, we are in control (as defined in the Proposed Rule) at the outset of the offering, but we will not be in control at the termination of that offering. If this rule goes into effect as currently drafted and without clarification that the test is to be applied only upon completion of the issuer partnership's offering, the expense of the offerings (which is borne by the investor) would increase dramatically. In addition, smaller transactions and those requiring immediate funding would no longer be viable as a typical accredited offering.

The burdens on small firms underwriting modest offerings (those under $5,000,000) are already extreme. Please do not add to that burden with this proposed regulation. (We would suggest that you strongly consider the unintended consequences of this proposed regulation - that is a reduction in the number of small real estate and venture capital offerings that are available to the investing public.)

If you must proceed with this proposed regulation, PLEASE give strong consideration to specifically requiring that the 50 percent of distributable profits or losses test be applied only at the COMPLETION of an offering.

Thank you.

LEC Investment Corp.

Alan Z. Engel,
President

AZE/jb

July 20, 2007

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, N.W. Washington, DC 20006

Dear Ms. Sweeney,

I am writing to you on behalf of Lombard Securities Incorporated with regard to the request for comments solicited in NASD Notice to Members 07-27 (Member Private Offerings).

Lombard Securities Incorporated has been an NASD member since 1991 and is largely owned by its registered representatives.

As indicated in NTM 07-27, proposed NASD Rule 2721 would offer an exemption for Member Private Offerings (MPO) to "employees and affiliates" of the issuer. We believe this exemption should be clarified. Not all registered representatives are employees--some could be independent contractors. In addition, it is not clear if other associated persons would be covered by this proposed exemption.

Additionally, other forms of beneficial ownership such as spousal ownership, IRA's, trusts, and like entities are not specifically addressed in the NASD's current proposal.

If it is later determined that the proposed rule, as presently written, does not grant an exemption to all associated persons, registered representatives and other affiliated parties, those associates may be disadvantaged by an inability to subscribe to MPOs due to a member's expense of preparing offering document(s) for a relatively small group of individuals.

In addition, many NASD members own affiliated companies which are involved in investment advisory and insurance activities. The proposed rule is not clear how associates of such entities would be treated.

We believe the rule should be unambiguous in exempting all associated persons of the member and all of its corporate affiliates, including board members, independent contractor representatives, other associated persons, and, especially, current shareholders. Without such arrangement, the tradition of broker and employee-owned small businesses in our industry would be disadvantaged.

Thank you.

Sincerely,

Daniel T. McHugh
Chief Executive Officer
Lombard Securities Incorporated
1820 Lancaster Street
Baltimore, MD 21231

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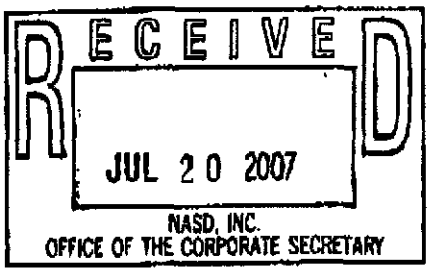


VIA ELECTRONIC MAIL

July 19, 2007

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, D.C. 20006-1506

RE: Proposed Rule 2721

Dear Ms. Sweeney:

In June 2007, the NASD issued Notice to Members 07-27 (NTM 07-27) which proposes Rule 2721 in an effort to lessen potential abuses on the part of NASD member firms or their controlling entities in the area of private placements. If adopted, this rule would impose upon the member firms or their controlling entities, various disclosure requirements, filing requirements, and restrictions on the use of proceeds from private offerings performed pursuant to the exemptions provided under SEC Regulation D. We have provided three alternative viewpoints as part of our comments to the proposed rule in an effort to allow the NASD to consider the rule from as many different perspectives as possible. In part I, we briefly discuss Congress' original intent in passing Regulation D. In part II, we provide our comments in support of particular additions to the proposed rule. Hereafter, in Section III of this letter, we provide comments in support of making amendments or deletions to the rule. In part IV, we provide the arguments in favor of not adopting the rule at the current time. We sincerely hope that these comments prove helpful in the NASD's efforts to improve upon its overall rulemaking for the benefit of its member firms and the protection of investors.

I. Introduction

Congress's original intent in 1982 for Rule 504 was to set aside a clear and workable exemption for small issuers to be regulated by state blue sky requirements, but by the same token, to be subjected to federal anti-fraud provisions and civil liability provisions. Similarly, Rules 505 and 506 under Regulation D were created by Congress to provide smaller or startup entities easier and cheaper access to often much needed

result of Rule 2721 if it becomes adopted in its current state. The proposed rule can and should be more narrowly tailored and can be revised to better address the specific concerns of the NASD as well as to better balance the interests of investors as protected by the NASD with the original intent of Regulation D.

II. Comments In Support of Additions to the Proposed Rule

A. Proposed Rule 2721 Lacks Any Protections for Member Firms or Control Entities in the area of Confidentiality

One of the many purposes served by a private placement memorandum ("PPM") is to inform the investor of the reasons to purchase a security as well as all of the risks associated with the purchase of the security (i.e., the reasons to not purchase the security). Many of the reasons offered in PPMs for the purchase of a security in a private offering include the existence of highly confidential and unique business strategies, competitive advantages, trade secrets, patents involving unique technology giving the member firm or a control entity a powerful edge over potential investors, and other similar highly confidential information. Proposed Rule 2721 offers no protections for confidentiality or ability to protect such information from the eyes and ears of individuals within and without the NASD, many of which come from and go to larger member firms that would greatly value information about such confidential matters easily derived from most PPMs. Therefore, in the case that Rule 2721 in some form is adopted, there should be added to any final Rule 2721, the right on the part of the member firm or its control entity to make and enforce as confidential and the right to black out confidential portions of the PPM prior to providing this confidential information to the NASD.

B. The Proposed Rule Lacks an Exemption Involving Prior Issued Convertible Debt or Other Classes of Securities.

Proposed Rule 2721, Subsection (e)(8) provides for an exemption in the case of securities issued in stock splits and restructuring transactions. However, there is no mention of transactions involving conversions from one class of securities (e.g., bonds or preferred stock) to another class of securities (e.g., common stock). Similar to stock splits and restructuring transactions, stock conversions involve non-cash transactions and the conversions are executed by an already existing investor that wishes to swap one type of security for another without the need for additional consideration or investments on the part of the investor. Therefore, stock conversions should also be included under the exemptions listed in Subsection (e)(8).

III. Comments in Support of Modifications or Deletions to the Proposed Rule

A. Proposed Rule 2721 Subsection (d) Should be Eliminated

Subsection (d) of proposed Rule 2721 should be eliminated as it arbitrarily sets a figure in the amount of eighty-five percent (85%) as the baseline under which a member or even its control entity cannot fall below when making decisions on how to utilize

offering proceeds. The use of proceeds section of most PPM's describes the anticipated or expected use of proceeds rather than the guaranteed or definite use of proceeds. The reason for any PPM to not be required to conform or even substantially conform to the described uses of the offering proceeds is to allow maximum flexibility to management due to the nature of smaller or startup businesses. The future capital requirements and use of any smaller company is highly speculative and uncertain. Any restrictions on the use of proceeds from an offering and on the parties responsible for running the day to day business affairs of the company will harm the company's management and a board's ability to run its business operations as it sees fit, which in turn, will harm the interests of shareholders. The NASD is not in any position to see the future, as a divine oracle or otherwise, of any smaller member company or control entity and therefore should not attempt to arbitrarily confine a smaller company management's discretionary use of offering proceeds to only 15% of the proceeds raised from any private offering.

Further, the 85% restriction on proceeds proposed under Subsection (d) does not eliminate the risk of abuse targeted by this restriction, namely that the proceeds are somehow not used by management in a way that serves the best interests of the company, be it in the form of promoting either short-term or long-term profitability. This perhaps being the unspoken but implied target of this Subsection (d). a more specific but separate rule can be proposed that requires that all proceeds obtained through a member's private offering be utilized in a manner that serves the best interests of the Company and all of its shareholders. However, a more specific rule may not be necessary due to such abuses usually being successfully resolved through private shareholder actions or derivative actions against organizations or their management. The NASD is therefore not needed to police such private shareholder actions when the courts have taken on this role successfully for many years at the request of private shareholders.

B. Rule 2721, Subsection (b), Should be Removed from the Proposed Rule Because A Notice Filing Requirement Does Not Correct the Types of Alleged Abuses Targeted by the NASD.

Under proposed Rule 2721, Subsection (b), no member or control entity may offer or sell any security in a Member Private Offering unless the PPM has been filed with the NASD at or prior to the time of the first placement of any such offering with an investor. Yet, under paragraph (c) of NTM 07-27, the NASD states that unlike filings under Rules 2710, 2720, and 2810, a member could begin offering MPO securities immediately after filing the PPM. This appears to equate to a new requirement for a notice filing rather than a prior review and approval by the NASD. Such notice filings already exist at the state level in many states. Further, a notice filing only guarantees that a PPM is created and sent to the NASD to put them on notice of a private offering. This notice can be successfully made with merely a requirement that a Form D be filed concurrently with the NASD. However, a notice filing does not guarantee that any PPM will actually be timely distributed to the investor or that the PPM will be ultimately provided at all. This notice filing also does not guarantee that the PPM will even contain adequate information or disclosures desired by the NASD, as the NASD will not have an opportunity to review and approve the PPM prior to the PPM's distribution by the member firm or control

entity. Therefore, the notice filing requirement found under Subsection (b) should remain the subject of state regulatory agencies and should be removed from the text of the proposed rule with the focus of any remaining rule being that of providing guidelines for a PPM that is presented to investors by or through a member firm. Alternatively, a concurrent filing of Form D with the NASD could suffice for this notice filing of a securities offering by a member firm or through a member firm by a control entity.

C. The Requirement that a Member's "Control Entity" Be Subject to Rule 2721 Should Be Deleted From the Rule

An attempt to require the member firm's "control entity" to come under the purview of NASD regulation is an attempt to create regulatory responsibility that has not previously existed. If the member firm has not participated in the offering in any manner and the only connection between the member and the parent is one of ownership, the NASD does not currently have clear or proper authority to affect or regulate the business conduct of such a controlling entity. A control entity is an entirely separate legal entity that should be run independently of the member. Therefore, no NASD jurisdiction should be proper in this case over a control entity.

However, if the NASD remains committed to including a control entity feature within any final rule, there should be an inclusion of a control entity only in the case that the control entity issues securities under all of the following circumstances: 1) there is the issuance of securities to customers of the member firm; 2) the securities are issued through the member firm or its representatives, and 3) there are underwriting or brokerage fees paid to the member firm or its representatives for the sale of any of the securities being offered. These circumstances, when combined, would create a sufficient nexus to warrant further regulatory interest on the part of the NASD towards a control entity.

IV. Comments Supporting That the Rule Not Be Adopted

A. Currently Adequate Protections for Investors Possibly Subject to Abuses Discussed Under NTM 07-27

The NASD in its NTM 07-27 stated that the issues it is attempting to address through its proposed rule 2721 are as follows:

- Misleading, incorrect, or selective disclosures in PPMs;
- Omissions and misrepresentations regarding selling compensation and the use of offering proceeds; and
- A failure to provide PPMs ("Private Placement Memorandums") to investors.

NASD Conduct Rules 2110, 2120, and 2310 along with Section 5 of the Securities Act of 1933, Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Act of 1934, SEC Rule 10b-5, and common law in the areas of negligence, breach of contract, and fraud have proven over time to be adequate to address problems that can arise with

member or nonmember "control entities" improperly affecting the issuance of private offerings to their customers or non-customers in the case of a control entity. Additionally, the broker's duty of fair dealing and duty to disclose risks and conflicts of interest to the customer provide even greater protections for brokerage customers. All of these areas of protection and recovery for investors provide adequate redress to investors that are harmed by the conduct of member firms or their control entities. As a result, additional protection that could be afforded under Rule 2721 would be duplicative and would simply add an unnecessary load to an already significantly large and complex assortment of previously effective and developed laws. Such additional regulation would also add to the already overburdened infrastructure of the NASD.

B. Unfounded Assumptions Not Based Upon Sufficient Evidence

The NASD appears to be making the assumption that NASD members require more oversight that nonmembers when involved with private placements for the member firms or their control entities. This assumption appears to be driving a belief that Rule 2721 will provide more protection for investors than is provided by current regulations and laws. This assumption that NASD Members are more prone to commit abuses than non-members in the area of private offerings, and thereby warranting disparate treatment from non-members, has not been shown to be based upon any conclusive evidence. Therefore, Rule 2721 may be premature and should only be proposed following accumulation of sufficient evidence that disparate treatment of member firms or control entities is actually required to reduce cases of alleged abuses related to private offerings. Further evidence that adoption of Rule 2721 will in fact be effective in eliminating the possible abuses targeted by the rule should also be performed before considering adoption of any form of Rule 2721.

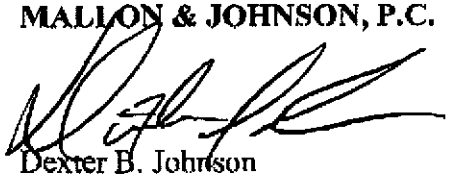
C. Rule 2721 is Unduly Burdensome on Smaller or Startup Member Firms

The disparate treatment under proposed Rule 2721 unduly burdens the smaller NASD members' ability to raise capital, thereby acting as a form of protection for the larger NASD members from future competition as a result of the larger members not having any need to raise capital through private placements. Therefore, if one cripples the smaller member's ability to raise capital it cripples the smaller member or creates a situation where there are less new members in the future due to the small member's or potential member's inability to raise sufficient funds to pay the legal fees and expenses required to produce an adequate PPM. The overall effect of this rule will be to reduce the number of smaller member firms which is in contravention with the intent of Regulation D. Regulation D has allowed and empowered smaller companies, and smaller members alike, to raise sufficient capital without the incurrence of the prohibitive costs associated with a PPM. It is not larger member firms that need protection from the smaller member firms; it is actually the reverse which is often the case.

D. The Effect of Proposed Rule 2721 May be to Further Restrict Investor's Access to Member Firm Private Offerings

It is probably safe to assume that as a result of Rule 2721 being adopted that many member firms, control entities, and prospective member firms will be unable to incur the expenses associated with the proper preparation of a PPM. This will most likely lead to fewer private placement offerings in the future by member firms, their control entities, and prospective member firms. Reducing the number of private offerings available to the average investor further eliminates the average investors' ability to benefit from the next generation of successful member firms that are fortunate enough to find a public market or even private equity market. The higher returns that often result from private placements are needed more by the average investor than accredited investors, who are by definition already financially secure. Overall, Rule 2721 will have a chilling effect on private placements and will have the effect of continuing to erect more obstacles in front of the average hard-working individual who desires to somehow be enriched through the discovery of a unique private member firm, or control entity, that yields higher returns through someday going public or liquidating through a private sale. Over the last thirty years, some of the most rapidly appreciating stocks sold on the NYSE or NASDAQ were those in the financial services industry, including member firms. These opportunities should continue to be made available to such average investors as a means of creating upward economic mobility for the middle class of America.

Respectfully submitted,
MALLON & JOHNSON, P.C.



Dexter B. Johnson

MANAGED FUNDS ASSOCIATION

July 20, 2007

Via Electronic Mail: pubcom@nasd.com

Attention: Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, D.C. 20006-1506

Re: NASD NTM 07-27
Proposed Rule 2721, Member Private Offerings

Ladies and Gentlemen:

Managed Funds Association ("MFA") appreciates the opportunity to make this submission of comments to the National Association of Securities Dealers, Inc. (the "NASD") on Notice to Members 07-27 regarding proposed Rule 2721, Member Private Offerings (the "Proposal").

MFA is the voice of the global alternative investment industry. Our members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policymakers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the over $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

Our interest in the Proposal arises from its potential impact on privately offered commodity pools and investment funds.

Scope of Proposed Rule 2721

We appreciate the NASD's efforts to protect investors from abusive and fraudulent member private offerings and commend the NASD for applying a beneficial ownership test to determine whether an entity is controlled by a member firm and thus subject to Proposed Rule 2721. The NASD's charge is to regulate the activities of its member broker-dealers. We are concerned that the scope of Proposed Rule 2721 is overly broad and overreaches the NASD's purview by potentially regulating the merits of non-member private placements. Specifically, the definition of "Control Entity" could extend beyond member private offerings and potentially regulate privately offered commodity pools and investment funds that are affiliated with an NASD member.

First, we do not believe that it is necessary for the NASD to regulate the substance of privately offered commodity pools and investment funds. Privately offered commodity pools and

investment funds are offered pursuant to section 4 of the Securities Act of 1933 ("Securities Act") and Regulation D thereunder. Congress recognized in passing the federal securities laws that registration of a security is a long and expensive process, and that in some circumstances the costs of compliance with registration greatly exceeded any public benefit. Thus, exemptions from the burdens of registration were written into the Securities Act as originally enacted in 1933. The Securities and Exchange Commission ("SEC") also recognized in adopting Regulation D that sophisticated or "accredited investors" could sufficiently fend for themselves and adopted Regulation D with limited disclosure requirements.

Additionally, privately offered commodity pools are already well regulated by the Commodity Futures Trading Commission ("CFTC") and the National Futures Association ("NFA"), and any additional regulation would be duplicative.

Commodity pools are operated or managed by a commodity pool operator ("CPO"). A CPO is generally required to register with the CFTC, and pursuant to the CFTC's Part 4 regulations, must provide to pool participants and file with NFA various disclosure documents. These disclosures include: general risks of futures trading and particular risks of the pool; fees and expenses; the business background and past performance of the CPO, commodity trading advisor ("CTA") and principals; certain material legal proceedings against the CPO or CTA during the past five years; conflicts of interest; intended trading methodology; use of proceeds; "break-even" point where profits exceed fees and expenses; and any other material information. A CPO must also provide participants with monthly account statements which report their income/loss and changes in net asset value, and certified annual reports which report the pool's financial condition, changes in financial condition, changes in ownership equity, and the participant's income/loss. In addition, the NFA conducts routine on-site examinations of CPOs.

We understand that the NFA and the New York City Bar will be submitting comments to the NASD also requesting that commodity pools be exempt from Proposed Rule 2721 and respectfully request that the NASD carefully consider their letters setting forth the regulatory requirements for commodity pools. As commodity pools are already subject to a comprehensive set of regulatory requirements, we believe that the Proposal would add a duplicative layer of regulation, raise regulatory costs for pools without providing additional benefits to investors, as well as potentially subject pools to inconsistent regulatory requirements. ***We recommend that the NASD exempt privately offered commodity pools from Proposed Rule 2721.***

Second, we appreciate the NASD's efforts to determine whether an entity is controlled by an NASD member firm for purposes of Proposed Rule 2721. Nevertheless, we are concerned that the "Control Entity" definition could subject privately offered commodity pools and investment funds that are affiliated with an NASD member to Proposed Rule 2721 and place them at a competitive disadvantage to other similarly situated funds that are not affiliated with an NASD member. Proposed Rule 2721 would subject funds that are affiliated with an NASD member to an additional and separate layer of regulation, and consequently, discourage NASD membership.

We are also concerned that privately offered commodity pools and investment funds could inadvertently or temporarily fall within the purview of Proposed Rule 2721 as a result of how the term "Control" is defined. In stating on page 5 of the Proposal that Proposed Rule 2721 would not apply to any private placements by any entity that does not meet the control test, including investment partnerships, direct participation programs and other private funds that the NASD member or its affiliate may organize, the NASD perhaps did not realize that for a short

period of time at the inception of a private fund, commodity pool or other investment fund, the receipt of "seed" money from NASD member firms or their affiliates who sponsor such funds to begin operations could trigger a private placement memorandum ("PPM") filing requirement under the rule that might never again apply because the 50% threshold is only temporarily exceeded.

It is not uncommon for a newly-formed fund to receive seed capital from an NASD member or its affiliate in order to allow the fund to start trading while it continues to raise capital from new investors. Such investments are also made to demonstrate the financial backing of the fund sponsor for its own program. While such a fund will likely cease being a "Control Entity" of an NASD member after its first closing, we are concerned that it could be swept under Proposed Rule 2721 if more than 50% of the fund is beneficially owned by an NASD member before the fund has raised capital from outside investors.

We recommend that the NASD limit the scope of Rule 2721 to private offerings by NASD members, or exempt from Proposed Rule 2721 commodity pools and investment funds (as discussed herein). We further recommend that the NASD modify the definition of a "Member Private Offering" as "a private placement of unregistered securities issued by a member or a control entity to finance the business or operations of the member exempt from the filing requirements of rules 2710, 2720 or 2810."

Finally, we do not believe Proposed Rule 2721 should apply to private investment funds, such as hedge funds that are exempt under section 3(c)(1) of the Investment Company Act of 1940 ("Company Act") ("3(c)(1) Funds"). In December of 2006, the Securities and Exchange Commission ("SEC") proposed raising the accredited investor standard for a natural person investing in a 3(c)(1) Fund, by requiring that a natural person be an accredited investor and have $2.5 million in investments. We support raising the accredited investor standard for natural persons investing in 3(c)(1) Funds as it will further safeguard that only sophisticated investors are invested in such funds.

Sophisticated investors do not need the protection of the SEC, nor the NASD. Thus, a 3(c)(1) Fund should not need to file a PPM with the NASD under Proposed Rule 2721 for investor protection reasons. ***We recommend that the NASD exempt 3(c)(1) Funds from Proposed Rule 2721.***

* * *

We appreciate this opportunity to comment on Proposed Rule 2721, and would be pleased to meet with you to discuss our comments further. Please feel free to reach me or Jennifer Han at 202.367.1140.

Sincerely,

John G. Gaine

John G. Gaine
President

MGL Consulting Corporation
10077 Grogan's Mill Road, Suite 300 / The Woodlands, Texas 77380 / 281-367-0380 / Fax: 281-364-1452

July 20, 2007

Via e-mail: pubcom@nasd.com

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington, D.C. 20006-1506

RE: NASD Proposed Rule 2721 - Comments for Consideration

Dear Ms. Sweeney:

MGL Consulting Corporation ("MGL") is a provider of regulatory and compliance solutions to broker/dealers, investment advisors and insurance companies. To this end, we represent NASD member firms in their efforts to comply with the various securities laws and regulations promulgated by the Securities and Exchange Commission ("SEC"), National Association of Securities Dealers ("NASD"), Municipal Securities Rulemaking Board ("MSRB"), and various other regulatory bodies. The NASD's proposed Rule 2721 (the "Proposed Rule") would affect many of these clients and MGL desires to seek clarification and submit comments regarding the proposed rule.

Negotiated Investments

The Proposed Rule appears to be focused on private placement investments that have historically been referred to as DPPs, and or "Pooled Investments" (such structures being referred to herein as "Pooled Investments"). In these investment structures, the sponsor generally structured the transaction (investment objectives, organizational structure, ownership structure, etc.), prepared the private offering memorandum or other disclosure document (collectively the "POM"), subscription documentation, and the marketing program, including documenting the arrangements for best efforts selling group participants and involvement in and or production preparation of the marketing material. When the above had been completed, theoretically, the Sponsor would commence the marketing of the specific program, hopefully in conformity with the disclosures set forth in the POM and related documentation.

Notwithstanding that, the Proposed Rule, as currently drafted, will have a significant and adverse affect on broker/dealers that are not engaged in the typical "Pooled Investment" products, but are engaged in negotiated private placement transactions with both qualified purchasers and accredited investors, in conjunction with their legal and accounting

professionals (such transactions being referred to herein as "Negotiated Transactions"). In Negotiated Transactions, there are typically a minimal number of investors, a transaction is proposed (generally in a short summary), and once a proposed investor expresses an interest in the transaction in concept, the sponsor/issuer and the investor negotiate the overall terms of the transaction, and the result of such negotiations are that the drafts of the POM and the closing documents are prepared, and ultimately finalized. Generally, when the documentation is finalized, the transaction "closes." Funding of the investors' financial obligation then occurs as negotiated, with actual funding being made to the investment entity structured for the specific transaction. As a result of the transaction flow on a Negotiated Transaction, it is clear that the Proposed Rule does not address the business realities of Negotiated Transactions, both as to filing requirements and the exemptions granted for investors. This is especially true for broker/dealers that have affiliated entities that develop real estate projects, are engaged in investment banking activities and or mergers and acquisition transactions, where all entities involved are Accredited Investors, as defined in Rule 501 of Regulation D, but may not necessarily be Qualified Purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, and that use the affiliated NASD member to raise funds for these projects.

Clarification for the Definition of "Control Entity"

The proposed definition in the Proposed Rule states in part, "The term 'control' for purposes of this Rule means beneficial ownership of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership." [2721(a)(2)] We would recommend that the definition be clarified to address the issues related to the questions set out below:

Question 1:

> *Question 1-A.* At what point in the business transaction and offering cycle would the term "control" be applied? By way of a real estate based example, suppose an NASD member has an affiliate ("BD Sponsor Affiliate"), which will team with a landowner to build a shopping mall on the landowner's property. To do so, they form an entity, the Mall Development Corporation ("MDC"), of which the landowner owns 40% while BD Sponsor Affiliate owns 60%. In order to fund the project MDC forms a partnership where it is the general partner. The partnership raises funds by selling limited partnership interests in "The Retail Mall Project LP," The LP is offered via a private placement. After the offering, BD Sponsor Affiliate will be entitled to substantially less than "50% of the distributable profits or losses of a partnership."
>
> Using a standard "Pooled Investment" structure, suppose BD Sponsor Affiliate includes the initial organizational limited partner and the General Partner, which collectively own 100% of the investment vehicle. After the offering and successful closing of the transaction, the "Organizational Limited" partner has no interest in the investment vehicle, and the General Partner has a 1% ownership interest in the investment vehicle, and a 20% profits interest after the investors obtain a preferred benchmark return.

Question 1-B: *B*ased solely on who is entitled to the distributable profits and losses of the partnership, would the examples in Question 1-A be a Member Private Offering? (BD Sponsor Affiliate is entitled to 60% of the profits and losses before the offering but less than 50% after the offering, and or BD Sponsor Affiliate and organizational partner own 100% before investors are accepted and 1% after investors are accepted.)

Question 1-C: In the example 1-A, now consider that MDC is the general partner of the partnership. MDC makes all management decisions for the partnership, and the limited partners do not have the ability to remove the General Partner. Since BD Sponsor Affiliate has a 60% say in who manages the partnership, but is entitled to less than 50% of the profits, would this be a Member Private Offering?

Question 2:

Would a flow-through concept apply to the definition of control entity? In the example above, suppose that instead of MDC forming a partnership and selling limited partnership interests, MDC formed a new corporation, Retail Mall Inc. ("RMI"). MDC owns 50% of RMI and outside investors own the other 50%. At some point in the future, Broker Dealer Sponsor Affiliate's NASD firm is engaged in the selling of RMI via a private placement. Since BD Affiliate's diluted interest is less than 50% (60% of 50% = 30%), would the issuer be a control entity?

Clarification for when a PPM will be deemed to be "filed"

In the case of a member private offering, 2721(b) requires PPMs be filed with the NASD's Corporate Finance Department "at or prior to the first time the private placement memorandum is provided to any investor."

Question 3:

When is a private placement memorandum (PPM) considered filed? In a Negotiated Transaction, while the investor may be provided a "summary or request for interest," until a potential investor expresses an interest in the proposed transaction, negotiations are not commenced, and by definition, there can be no "disclosure" document in that the transaction is undefined and the business terms are open.

Additionally, with respect to one client in particular of MGL, many of its customers have obligations outside of their local community and are engaged in frequent travel. It is not unusual for the affiliated sponsor to engage in discussions and negotiations over several days or even a several-week period with a small group of investors, to finalize the business transaction and subsequently, the PPM, and then to e-mail same to the investors. Some of these investors review the final PPM copy the day of receipt, forward the appropriate

funds to the appropriate recipient, and then leave town or even the country, whether for business or pleasure, on the same day the PPM is received. If a hard copy must be sent to the NASD, and such is not considered "filed" by the NASD until the NASD receives its hard copy, this will place an additional burden on the issuer and placement agent. In the example that was just described, a preferred definition of "filed" would be for the NASD to initially accept a PDF version via e-mail. The next best option would be to define "filed" as the date that the document was picked up at the NASD member's office by an overnight courier such as DHL or Fed Ex.

Clarification of offerings by wholesalers

In the Rule 2721 draft, a proposed exemption is allowed for "offerings in which a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers" [Please refer to 2721(e)(3)]. If the intent of this provision is to provide an exemption for wholesalers who serve as the lead or managing placement agent, but do not engage in any actual direct selling to investors, such an exemption would be welcomed. However, the wording of the second clause of the proposed exemption, "and sells unregistered securities to other unaffiliated broker-dealers" appears to be problematic, as it implies that the lead broker/dealers must take a principal position by purchasing the private placements prior to marketing them to their customers, and this rarely if ever happens. We believe that this should be clarified in the final version of the Proposed Rule.

Request to exempt offerings with a small group of investors and to exempt experienced firms without disciplinary history

As the Proposed Rule is currently drafted, it would appear to apply to broker/dealers with affiliates who are involved in real estate, oil and gas, mergers and acquisitions and investment banking firms that are engaged in structuring Negotiated Investments, i.e., firms that negotiate deals with small groups of investors. As discussed earlier, the Negotiated Investment business model is focused on a small group of people, all of whom are accredited investors as defined in Rule 501 of Regulation D, and negotiations and counter proposals transpire over a period of time, and once the parties have agreed to the terms, legal documents are drafted and signed. The Proposed Rule in its current format would require the deal proposals and each revision to be filed with the NASD. As the Proposed Rule's intent is presumably to address Pooled Investments (syndications, hedge fund offerings, and the like), we believe that it would be appropriate for an exemption to be made for deals that have small groups of investors, such as six or less, where all of the investors are accredited.

Furthermore, since market regulation issues related to private placement transactions transgressions appear to be limited to certain broker/dealers and individuals, it appears that it would be sound regulatory rule-making to only require filings for broker/dealers that are new to private placements, and to those firms that have a history of private placement transgressions. Such a precedent already exists in the form of the NASD's advertising rule that requires all firms to file their advertising for the first year that such is utilized, but thereafter only requires future filings for certain products offered to the

public or where the NASD has determined that a problem may exist. Perhaps broker/dealers could be required to file their deals for the first year that they offer private placements, unless NASD exams or reviews of the filed documents indicate material problems. If problems were detected, a longer filing period would be imposed. This approach would provide for the protection of the investing market, while not overly burdening those firms that are currently in compliance with the intent of the Proposed Rule.

Finally, while it appears to be a notice platform, to the extent the NASD does not have clear guidelines with respect to review time, the Proposed Rule may result in having a "chilling effect" on the private placement market. To the extent the NASD requires pre-filing, but is not required to make prompt review and comment, but reserves the right to "subsequently determine" the disclosures are inadequate, it gives the NASD no information that is not currently available to it through its audit program. Further, it has the potential to create additional confusion to those marketing Negotiated Investments and Pooled Investments. State laws and SEC rules and regulations provide ample guidance on this matter; additional rules only exacerbate the ability of a compliant to navigate the regulatory minefield regarding the offering of investments. To this end, we believe to the extent the Proposed Rule is implemented, it should provide clear guidance on the timeline for expectation of comments from the NASD, so that Firms could receive some benefit from the filing and review process.

"The NASD requests comment on whether the proposed rule should apply to these other entities [i.e. private placements which NASD members offer but where the member does not meet the control test]."

We feel that such would impose an unnecessary burden on the industry and would undo or reverse the exemptions that the SEC and related state jurisdictions have seen fit to implement (i.e. Regulation D, Section 4(2), etc.). If the SEC feels that the exemptions are inadequate, they may avail themselves of the legal and regulatory process to change such.

Furthermore, in reviewing the nine cases cited by the NASD in Endnote 3 on page 6 of Notice to Members 07-27 as examples of why proposed Rule 2721 is necessary, in several of the cases, the major problems in the offerings were not inadequate disclosures or material inaccuracies (although, such was present in some instances). Moreover, the problems in the cases cited appear to have been adequately addressed by rules and regulations that are currently in force and subject to the NASD's current exam program. To the extent that broker/dealer firms and or individuals have incurred material rule violations with respect to their private placement offerings, perhaps they, and not the general NASD membership should be subject to a filing requirement, and possibly, they should be subject to a pre-filing requirement (please refer to the analysis below as it appears that in many of the cases, a filing requirement would not have prevented some of the more egregious violations. However, in some cases one might argue that the NASD would have at least been alerted to a potential problem within a few days of the offering).

Concerning the above, a review of the NTM Disciplinary Actions, Press Releases, and Hearing Panel Decisions, that were referenced in Endnote 3, and in some instances the Public Disclosure Documents for the referenced firms, indicated the following:

(1) *Franklin Ross, Inc.* - The primary finding stated that the firm "failed to disclose material facts in a private placement memorandum";

(2) *Capital Growth Financial LLC* - While the NASD cited the firm for utilizing marketing materials that the proposed rule is designed to detect, the greater problem would appear to be that the firm "*used general solicitation sales techniques and sold the securities to non-accredited investors, thereby eliminating the offering from any registration exemption*";

(3) *Craig & Associates* - The Notice to Members actually only listed an action against Gary Lynn Craig, not Craig & Associates. The notice stated "he [Craig] participated in the preparation and distribution of sales literature that contained unwarranted and misleading information." However, it should be noted that Mr. Craig and his firm would presumably have been profiled for increased scrutiny as one disclosure item cites them for failure to properly supervise an individual that offered unregistered securities, and a second disclosure item cites Craig and his firm for failing to promptly transmit funds to a properly set-up escrow account;

(4) *Online Brokerage Services, Inc.* - The firm was cited for engaging in a public offering of its securities without filing the required documents with the SEC and the NASD, and it was cited for changing the terms of the offering without offering a rescission letter to the investors who had committed to the offering. The only allusion to inaccuracies in the offering materials was that during the offering it was represented that the securities being offered were exempt from SEC registration when in fact they were not;

(5) *IAR Securities/Legend Merchant Group* - The NASD stated that the firm or a named principal "made a misrepresentation in a Private Placement Memorandum (PPM), failed to disclose material facts in the PPM, or failed to disseminate supplements to the PPM disclosing materials facts." However, the findings also noted that at the time of the offering the firm's NASD Membership Agreement did not permit the firm to engage in private placements;

(6) *Shelman Securities Corp.* - In a press release, the NASD stated that it had filed a complaint against the firm and a principal for "securities fraud in connection with an unregistered hedge fund offering." Other allegations claimed that approximately 30% of the funds raised "was paid to Shelman, the exclusive underwriter of the offerings, and Prism Independent Consulting, Inc., an entity owned by Parman, for purported expenses, fees, and commissions." The NASD also alleged that the private placement memorandum was "inaccurate and incomplete";

(7) *Neil Brooks* - While the press release focused on Brooks being cited for "conducting a fraudulent hedge fund offering," it should be noted that the press release also stated that

he had engaged in a private securities transaction and that he was not properly licensed to offer and sell securities. Thus, even if the proposed rule were in effect at the time of the offering, it would never have been filed with the NASD;

(8) *Dep't of Enforcement v. L. H. Ross & Co., Inc.* - The Hearing Panel concluded that the firm was guilty of "participating in public offerings and sales of unregistered securities" and of "making material misrepresentations and omissions of fact in connection with the offer, sale or purchase of securities issued by L.H. Ross & Company, Inc.";

(9) *Dep't of Enforcement v. Win Capital Corp*. - The Hearing Panel dismissed the NASD's case against the respondents, thus no rule violations were found to have occurred.

Thank you for your thoughtful consideration of the comments contained herein.

Sincerely,

Curtis N. Sorrells

Curtis N. Sorrells
Vice-President, Regulatory Affairs
MGL Consulting Corporation

NATIONAL FUTURES ASSOCIATION

July 20, 2007

Via E-mail (pubcom@nasd.com)

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

Re: Proposed Rule 2721; Member Private Offerings

Dear Ms. Sweeney:

National Futures Association (NFA) appreciates the opportunity to comment on proposed NASD Rule 2721. As a registered futures association under the Commodity Exchange Act (CEA) and a self-regulatory organization for the futures industry, one of NFA's responsibilities is to oversee the regulatory requirements for registered commodity pool operators (CPOs) and their regulated commodity pools. Proposed Rule 2721 would result in duplicative regulatory requirements for these entities. Therefore, we respectfully request that NASD exempt regulated commodity pools from its proposed requirements.

Theoretically, any collective investment vehicle that trades one futures contract is a commodity pool and its operator is a CPO governed by the CEA.[1] The Commodity Futures Trading Commission (CFTC), has, however, created a number of exclusions and exemptions by rule. CFTC Regulation 4.5 excludes certain otherwise regulated entities (e.g., registered investment companies) from the very definition of commodity pool operator, taking them outside of the CEA's reach. CFTC Regulation 4.13 exempts CPOs who operate pools meeting various criteria (e.g., sophisticated investors, limited futures activity) from the CEA's registration requirements, which means that the entities operating these pools are subject only to the CEA's antifraud provisions for their conduct relating to those pools.

[1] The CEA and CFTC rules reach collective investment vehicles indirectly by imposing registration and other requirements on the entities operating those vehicles. Since the operator makes legal and operational decisions and has the authority to act on the pool's behalf, this is an effective regulatory scheme.

Non-exempt pools are subject to the CEA's registration requirements and to CFTC and NFA rules. Except for Rule 4.7 pools (discussed below), these rules require the CPO to prepare a written disclosure document, to file the document (and any amendments) with NFA at least 21 days before its first use, to distribute the document to participants along with (or prior to) the subscription agreement, and to provide participants with any material amendments. The disclosure document must contain a wide variety of required information, including:

- A prescribed risk disclosure statement, plus a discussion of the principal risk factors for the particular pool;
- The pool's investment program and use of proceeds;
- A description of all fees and expenses to be incurred by the pool, including a break-even table that includes incentive fees, trail commissions, brokerage fees, and organizational and offering expenses; and
- Any other information necessary to ensure that the document is not misleading.

NFA reviews each disclosure document filed with NFA, including those voluntarily prepared and filed by 4.7 pools. NFA's review is designed to ensure that the documents include all necessary information and that the investing public receives adequate disclosure about the investments being offered. If we have concerns regarding inadequate or misleading disclosure, we require the CPO to revise the disclosure document before using it. In the past year, NFA has reviewed disclosure documents from 47 public commodity pools, 13 Rule 4.7 pools, and 323 pools that are not required to register their securities with the SEC but do not qualify for Rule 4.7 relief.

All pools must provide participants with year-end financial statements and must file those statements with NFA. NFA analyzes each one of these statements, most within 30 days of receipt. This review examines whether the financial statement adequately reflects the pool's assets and liabilities and is consistent with any disclosure document on file, and it focuses special attention on unusual balances and significant changes in the pool's net asset value. NFA looks at the pool's entire financial statement, with the greatest emphasis on the pool's futures activities.

NFA has a number of programs to monitor CPOs' compliance with applicable rules and regulations. NFA's on-site examinations provide the most comprehensive review. During these examinations, NFA staff looks for and reviews transactions between the CPO and its pools, transfers between the CPO's pools, and the CPO's banking relationships. Staff performs basic testing on all the commodity pools operated by the CPO, including reviewing the pools' participant lists, solicitation materials, additions, and withdrawals. In addition, NFA uses a risk-based approach to select and test one pool in detail. In choosing this pool, NFA considers a number of factors, including the number of participants in the pool, the pool's total net asset value, exemptions held by the pool, and whether NFA conducted detailed testing on the pool in

a prior exam. NFA reviews the pool's financial records, including its assets and liabilities, with an emphasis on the pool's futures transactions, and NFA confirms the existence of non-futures assets—including securities, cash, swaps, and other financial instruments—that have a material effect on the pool. NFA also reviews the pool's trading activity for consistency with its disclosure document or offering memorandum.

NFA currently examines approximately 300 CPOs every year. CPOs are generally examined within 3 years after becoming active and every 3-4 years thereafter. Under NFA's risk-based approach, we examine CPOs more frequently when we have reason to believe that a CPO or any of its pools poses undue risks.

Rule 4.7 pools, which have more sophisticated participants, are exempt from some of the CFTC's recordkeeping and disclosure requirements but must provide participants with quarterly net asset information and with an annual report containing financial information about the pool and must file the annual report with NFA. Although they are not required to provide a disclosure document or private placement memorandum, we have noted during the course of our examinations that most of them use a private placement memorandum that includes the full list of disclosures required for other regulated pools. Furthermore, CFTC Regulation 4.7(b)(1) provides that an offering memorandum used to solicit participants must include any disclosures necessary to ensure that the information it contains is not misleading.

As you can see, commodity pools that are not excluded or exempt under CFTC Rules 4.5 or 4.13 are already subject to a comprehensive regulatory regime. Therefore, we respectfully ask NASD to treat commodity pools similar to the offerings identified in Proposed Rule 2721(e) and carve them out of its proposed requirements.

Thank you for the opportunity to comment on the proposal. If you have any questions, or if we can be of any further assistance, you can contact me by e-mail at tsexton@nfa.futures.org or by telephone at 312-781-1413.

Very truly yours,

Thomas W. Sexton
Vice President & General Counsel

(kpc/CPOCTA Issues/NASD Private Offerings, Comment Letter)

NEW YORK CITY BAR

COMMITTEE ON FUTURES & DERIVATIVES REGULATION

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July 10, 2007

Office of the Corporate Secretary
NASD
1735 K Street, N.W.
Washington D.C. 20006-1506

Attn: Barbara Z. Sweeney, Senior Vice President and Corporate Secretary
Email Address: pubcom@nasd.com

Re: Notice to Members 07-27: Member Private Offerings

Dear Ms. Sweeney:

The Committee on Futures and Derivatives Regulation (the "Committee") of the New York City Bar Association (the "Association") is pleased to provide comments on National Association of Securities Dealers Notice to Members 07-27 regarding "Member Private Offerings" (the "Proposal").

The Association is an organization of over 22,000 lawyers. Most of its members practice in the New York City area. However, the Association also has members in nearly every state and over 50 countries. The Committee consists of attorneys knowledgeable in the regulation of futures contracts and other derivative instruments and it has a history of publishing reports analyzing regulatory issues critical to the futures industry and related activities, including those affecting commodity pool operators. The Committee's interest in the Proposal arises from its potential

effect on privately offered commodity pools. The Committee appreciates the opportunity to comment on the Proposal.

Intended Scope of Proposal

The Committee's initial concern is with the intended scope of the Proposal. The definition of "Member Private Offerings" and "Control Entity" could be read to include not only offerings by members of their securities, but also, without limitation, all offerings of securities by entities that control or are under common control with a member, or are controlled by a member, with "control" determined by a standard of greater than 50% beneficial ownership.

The Committee is concerned about the potential application of the Proposal to situations such as the following. Privately offered commodity funds are generally organized as limited partnerships, trusts or limited liability companies. The general partner, managing owner, managing member, or similar entity is the commodity pool operator of the fund. Such a pool operator may be under common control with a member, under the Proposal's definitions. The member distributes pool interests. Privately offered commodity pools are offered pursuant to SEC Regulation D and comparable exemptions from securities registration at the state level. The investment interest of the pool operator and of any affiliate acting as the initial investor generally would not exceed 50%. Under partnership, trust, or limited liability company law, however, control over the fund and its operations is effectively exercised by the pool operator. Moreover, fund sponsors will often contribute a substantial amount as seed capital in order to allow their funds to meet the minimum investment amount to begin trading immediately, and avoid the need to hold investor funds in escrow or otherwise delay investment of subscription proceeds. In such cases, we recommend that the Proposal contain an exclusion for situations where the affiliate of a member makes contributions to a fund that exceed 50% of capital for the limited purpose of meeting the minimum contribution requirements as long as the limited duration of such an investment is disclosed to potential investors.

Section 1.A of the Proposal states that the power to direct the management or policies of a corporation or partnership alone would not constitute "control" for purposes of the control entity defined in the Proposal. Section F of the Proposal states that it would not apply to private offerings such as "investment partnerships, direct participation programs, and other private funds that the member might organize." However, the text of proposed rule 2721 does not contain any similar limiting language. We believe that the intent is to exclude an investment fund affiliated with a member (as described in the example above) from the coverage of the Proposal, but believe that that should be stated definitely in the language of the rule. With respect to the Proposal's specific request for comment on whether it should apply to investment partnerships and similar entities, the Committee believes that such regulation is unnecessary for the reasons stated below.

Potential Application to Privately Offered Commodity Funds

The Committee believes that privately offered commodity funds are already subject to comprehensive regulation that obviates the need for the additional regulation contained in the Proposal. If privately offered commodity pools are intended to be covered by the Proposal, the

Committee has a concern that the Proposal would impose duplicative regulation on privately offered commodity pools. Such pools are regulated by the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA) under the Commodity Exchange Act. Specifically, the CFTC's Part 4 rules govern in detail the contents of commodity pool operator disclosure documents, which must be provided to investors in such pools no later than the time the pool operator delivers a subscription agreement to a potential investor. Pool disclosure documents must be submitted to the NFA prior to use, and are reviewed by NFA staff for compliance with CFTC disclosure document regulations.

Commodity pool operators and their associated persons must be registered under the Commodity Exchange Act in those capacities, and are subject to fitness screenings and testing requirements administered by the NFA. Commodity pool operators are subject to record-keeping requirements regarding their pools, and must prepare and submit periodic reports to pool investors; annual reports are required to be filed with the NFA. The NFA conducts periodic onsite audits of commodity pool operators.

The Proposal would establish an additional set of disclosure requirements and filing requirements for Member Private Offerings. While the Proposal provides only general statements about the disclosure requirements that would be imposed, the Committee is concerned that, either through future development of proposed rule 2721 or through staff interpretations applying it to filed documents, privately offered commodity pools will be subject to disclosure requirements that conflict with or are applied differently than those applied to such pools under the CFTC Part 4 rules.

Note 8 of the Proposal states that the NASD would not issue a no objections letter in connection with offering memorandum filings. The Proposal therefore leaves open the risk to offerings that there would be a subsequent determination that disclosures are "incomplete, inaccurate or misleading." Given the absence of any specific guidance as to the type of disclosures that would satisfy the general disclosure standards outlined in the Proposal, the issuer and the offering would remain exposed to the risk that such findings could be made after an offering has been completed or substantially completed. In contrast, the commodity pool disclosure document review process applied by the NFA involves review of the filed disclosure document for compliance with the Part 4 rules, and notification by NFA staff that the review has been completed. If there are deficiencies noted, in that requirements of the CFTC part 4 rules are not met, the pool operator must make the necessary corrections to the disclosure document and then refile it for review by the NFA. We submit that this process provides superior regulation of pool disclosure material content than that contained in the Proposal. If the intent of the Proposal is to apply to the offering memoranda of privately offered commodity funds, the Committee advocates that privately offered commodity pools be exempted from both disclosure requirements and filing requirements because they are already subject to a well-established regulatory regime under the Commodity Exchange Act.

General Issues

The Committee also has general questions about the intended application of the terms of the Proposal.

First, in its discussion of the use of offering proceeds, the Proposal establishes a requirement that at least 85% of the offering proceeds be applied to the business purposes identified in the offering memorandum. How would such a numerical limit be applied to offering proceeds if an offering were to have multiple closings? Presumably the standard would apply to the total amount raised. It would be helpful to clarify this point.

Second, the Proposal does not contain any implementation schedule or prospective effective date. It is not clear how the Proposal would be applied to current or ongoing offerings. Would such offerings be grandfathered from the requirements of the Proposal, or would they be required to restructure their terms to comply with it? This point should also be clarified.

Third, the Proposal states in section (b) that the private placement memorandum of an offering subject to the rule must be filed with the Corporate Financing Department. We believe that the Proposal should be clarified to state whether marketing materials used in subject private offerings must also be filed. Given the purposes of the filing requirement, and the absence of any prior review of filed documents, we do not see any need for marketing materials to be filed, but believe that the Proposal should address this point directly.

Fourth, note 7 to the Proposal states that performance and management fees earned by a general partner would not be included in the determination of partnership profit or loss percentages. We believe that this point should be stated directly in the rule.

The Committee welcomes any questions about these comments.

Very truly yours,

Michael Sackheim,
Chairman

New York City Bar Association
Committee on Futures & Derivatives Regulation
Michael Sackheim, Chair
David Form, Secretary

Tammy Botsford
Christopher Bowen
Louis Fox Burke
Jan Paul Bruynes
Maria Chiodi
Ian Cuillerier
Craig Stephen Deardorff**
Elodie A. Fleury
Geoffrey B . Goldman
Joyce M. Hansen
Douglas E. Harris
Joyce Hansen¶
Audrey R. Hirschfeld
Jason Jurgens
Gary Edward Kalbaugh
David Harlan Kaufman
Dennis Anthony Klejna
David Kozak*
Steven Lofchie
Robert M . McLaughlin
Richard A. Miller
Charles R. Mills
M. Shadee Nicholes
Camille L. Orme
Donna M. Parisi
Ernest T . Patrikis
Allan Rooney
Joshua B. Rovine
James M . Sanders
Howard Schneider
Timothy P. Selby
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Adjunct Members
Conrad G. Bahlke
Robert F . Klein
Cindy W. Ma
Rita Molesworth
Stephen Jay Obie¶
Edmund R. Schroeder
Steven F. Selig
Lore C . Steinhauser¶

* Chair and Member of Subcommittee that drafted this comment letter.
** Member of Subcommittee that drafted this comment letter.

¶ This member of the Committee did not participate in this comment letter.

¶ These Adjunct Members did not participant in this comment letter.

PFG Distribution Company
610 West Germantown Pike, Suite 460 • Plymouth Meeting, Pennsylvania 19462 • Telephone 484-530-4800 • Facsimile 484-530-9272

July 19, 2007

Barbara Z. Sweeney
NASD
Senior Vice President and Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Re: NASD Notice to Members 07-27
Member Private Offerings;
NASD Requests Comment on Proposed Rule 2721 to Regulate Member Private Securities Offerings

Dear Ms. Sweeney:

PFG Distribution Company ("PFG") and AGL Life Assurance Company ("AGL") are submitting this comment letter in response to the request for comments made by the NASD in Notice to Members 07-27 ("NTM") with respect to Proposed Rule 2721 ("Proposed Rule") pertaining to private placements of unregistered securities issued by an NASD member ("Member Private Offerings" or "MPOs"), as the terms Member Private Offerings and MPOs are used in the NTM.

PFG and AGL appreciate the opportunity to comment on the Proposed Rule. PFG is an NASD member firm. PFG currently conducts two types of business: (1) Broker or dealer selling variable life insurance or annuities; and (2) Other: Distributes variable annuity and variable life contracts on a private placement basis. AGL is an affiliate of PFG. As part of its business, PFG engages in the sale of AGL variable life insurance and annuity products. These life insurance and annuity products are offered and sold without registration under the Securities Act of 1933, as amended (the "Securities Act") pursuant to exemptions provided in the Securities Act and Regulation D promulgated thereunder. AGL is a life insurance company subject to the supervision and principal regulatory jurisdiction of the Pennsylvania Department of Insurance and is subject to regulation by insurance departments of those other states in which AGL issues life insurance and annuity products.

PFG and AGL submit that the Proposed Rule should not apply to private placements of variable life insurance and variable annuity products issued by a member or member affiliate or a "control entity" of a member. Further, the definition of "control entity" should exclude insurance companies, insurance company separate accounts and "Offerors" as the term "Offerors" is defined in Rule 2820.

As drafted, the Proposed Rule appears to apply to all private placement offerings of variable life insurance and annuity products by AGL, in its capacity as a "control entity" of PFG. However, the required contents of the disclosure document ("Disclosure Document") that accompany AGL's private placement offerings of these products are already addressed in Regulation D. More importantly, the contents of such Disclosure Document, as well as the contents and operation of the variable life insurance and annuity products issued by AGL pursuant to such Disclosure Document, are comprehensively regulated under applicable state insurance laws.

Under these circumstances, PFG and AGL believe that adoption of the Proposed Rule without the modifications requested herein will add significantly to the regulatory burden of members and member affiliates, such as PFG and AGL, without providing protection to investors beyond that already made available under federal securities laws and state insurance laws.

Life insurance companies are highly regulated entities that are subject to supervision and complete oversight by state insurance departments. To cite just one example, the permissible investments that may be made by an insurance company, both for its own account and on behalf of life insurance and annuity contracts issued by the company, are thoroughly regulated under state insurance laws.

Life insurance companies are required to file detailed, periodic statements of their operations and financial condition with the insurance regulators of all states in which such companies do business. These filings are publicly available.

Additionally, the terms of the life insurance and annuity products issued by insurance companies are subject to comprehensive regulation by state insurance departments. Many provisions of life insurance and annuity contracts are mandated by state insurance codes, or are subject to independent review and approval by state insurance regulators.

Moreover, the uses of the premiums received by the insurance company upon issuance of a variable life insurance or annuity contract are limited by applicable state insurance laws. All premium received, net of applicable charges payable under the contract must be allocated by the issuing insurance company to its separate account containing the investment options available under the contract. Similarly, the charges that an insurance company may assess in connection with a variable life insurance or annuity contract are either directly specified by state insurance statutes or are subject to limits set forth in these statutes (such as distribution charges.) Under these circumstances, the requirement on "use of proceeds" contained in the Proposed Rule are, at best, duplicative of existing state insurance laws, and are conceivably in conflict with such laws.

Further, the offer and sale of variable life insurance and annuity products by NASD member firms are already regulated by the NASD. The offer and sale of variable life insurance and annuity products are addressed in the Rules and are the subject of a number of Notices to Members and Interpretive Memoranda. (Currently, the NASD web site

posts 16 links to Notices to Members in connection with Rule 2820 – Variable Contracts of an Insurance Company.) In addition, as noted above, purchasers of life insurance and annuity products already have access to copious amounts of information about the issuer insurance company and its products through the publicly available filings made by such company with state insurance regulators.

According to the NTM, the Proposed Rule is intended to provide investor protections with respect to private offerings by a member that are parallel to the protections provided by Rule 2720 with respect to a member's public offerings. Rule 2720 expressly carves out insurance company separate accounts and registered investment companies from the definition of "affiliate" for purposes of Rule 2720. Accordingly, a similar exclusion from "control entity" should apply to insurance company separate accounts and insurance company issuers.

Definitions

PFG and AGL request the addition of a new **Section (3) under Paragraph (a) Definitions, of the Proposed Rule:**

(a) Definitions

...

(3) Exclusions to the Definition of Control Entity

None of the following shall be considered a "control entity" for purposes of this Rule:

(1) an "insurance company" as defined in Section 2(a)(17) of the Investment Company Act of 1940, as amended;

(2) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act of 1940, as amended; and

(3) an "Offeror" as defined in Rule 2820.

Proposed Exemptions

The Proposed Rule includes several exemptions, including MPOs sold to institutional accounts (as defined in NASD Rule 3110(c)(4)) and qualified purchasers (as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940). In order to maintain consistency with the intent and provisions of Section 4(2) of the Securities Act and Regulation D thereunder, Rule 2721 should also exempt MPOs offered and sold to accredited investors (as defined in Rule 501(a) of Regulation D). Further, for the reasons described herein, the Proposed Rule should also exempt offerings sold to purchasers and proposed purchasers of variable contracts (as defined in Rule 2820).

PFG and AGL request the addition of **new subparagraphs (G) and (H) to Section (e)(1) of the Proposed Rule:**

(e) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) offerings sold solely to:

...

(G) an "accredited investor" as defined in Section 501(a) of Regulation D of the Securities Act of 1933, as amended;

(H) purchasers and proposed purchasers of "variable contracts" as defined in Rule 2820.

Proposed Rule 2721 would exempt certain types of offerings from the Proposed Rule. PFG and AGL request the addition of **new paragraphs (9) through (12) to Section (e) of the Proposed Rule:**

(e) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

...

(9) offerings made pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act");

(10) offerings made pursuant to or in reliance on Regulation D under the Securities Act;

(11) offerings of "variable contracts" as defined in Rule 2820;

(12) offerings of exempted securities as defined in Section 3(a)(8) of the Securities Act.

Offerings by Members or a Control Entity

According to the NTM, the Proposed Rule would establish disclosure and filing requirements and limits on offering expenses for private placements by members of their own securities or those of a "control entity." A "control entity" for purposes of the Proposed Rule is defined as an entity that controls, is controlled by or is under common control with a member or its associated persons. The term "control" for purposes of the Proposed Rule is determined based on beneficial ownership 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. The NTM further provides that the power to direct the management or policies of a corporation or partnership alone – absent the majority ownership or the right to a majority of profits - would not constitute "control" for purposes of the "control entity" definition in the Proposed Rule.

As proposed, Rule 2721 could conceivably apply to offerings of unregistered securities made by a "control entity" of a member even if the member did not directly sell or distribute such securities. Under the circumstances, the NASD could be viewed as attempting to regulate an issuer over which it has no regulatory authority. For example, assume that ABC Insurance Company ("ABC") issues variable annuity and insurance products that are exempt from registration pursuant to the Securities Act and Regulation D. ABC has entered into a principal underwriting agreement wherein it authorizes its affiliated broker dealer ("Affiliated Broker Dealer") to enter into selling agreements with non-affiliated broker dealers to sell the variable products of ABC, pursuant to Rule 2820(e). Subsequently, ABC offers and sells a variable annuity product to an accredited investor. The insurance agent that sold the variable annuity product is registered with a broker dealer that is not affiliated with ABC. Under the facts presented, the Affiliated Broker Dealer did not issue unregistered securities. Under the Proposed Rule, a member or associated person may not *participate* in a Member Private Offering unless a private placement memorandum ("PPM") is provided to each investor and the PPM contains specific disclosure items. However, since no definition has been assigned to the term "participation" under the Proposed Rule, it is unclear whether the Unaffiliated Broker Dealer that did not issue unregistered securities would be subject to the Proposed Rule.

Should the NASD decline to adopt the exclusions to the definition of control entity and the additional MPO exemptions requested herein, PFG and AGL are requesting that the NASD clarify the Proposed Rule to specifically define "participation" and reflect that the disclosure requirements only apply if the member or associated person directly sells or distributes the MPO to the purchaser and that the disclosure requirements do not apply to a member or associated person that indirectly offers and sells the MPO through an underwriting agreement.

Disclosure and Filing Requirements

The Proposed Rule would require members to provide each investor in an MPO (whether accredited or unaccredited) with a PPM that includes certain information. The disclosure of such information to accredited investors is not currently required under the Securities

Act or Regulation D. See Section 502(b) of Regulation D. The NASD recognizes and acknowledges that "SEC Regulation D does not require disclosure documents to be prepared or provided in offerings made solely to accredited investors." See Endnote 4 of the NTM.

The Proposed Rule would require the members to file the PPM with NASD at or prior to the first time that the PPM is provided to any investor. In addition, any amendment or exhibit to the PPM would be required to be filed with NASD under the Proposed Rule. Neither Section 4(2) of the Securities Act nor Regulation D requires that issuers file a PPM, exhibit to the PPM or amendment to the PPM with the SEC, in a sale made to accredited investors. The NASD recognizes and acknowledges that "SEC Regulation D does not require disclosure documents to be prepared or provided in offerings made solely to accredited investors." See Endnote 4 of the NTM.

Regulation D and private placements have been the subject of recent discussion, new rule releases and proposed rule changes by the Securities and Exchange Commission ("SEC") (SEC Proposed Release No. 33-8814 – Electronic Filing and Simplification of Form D; Release No. 33-8766 – Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles; and SEC Proposed Release No. IA -2266 – Registration under the Advisers Act of Certain Hedge Fund Advisers); and litigation (*Phillip Goldstein, et al. v. Securities Exchange Commission* – see August 6, 2007 statement of former SEC Chairman Christopher Cox concerning the SEC's decision not to seek en banc review of the decision of the U.S. Court of Appeals for the District of Columbia). As recently as July 11, 2007, the SEC voted to adopted a new antifraud rule under the Investment Advisers Act that clarified the SEC's ability to bring enforcement actions under the Advisers Act. The rule will apply to all investment advisers to pooled investment vehicles, regardless of whether the adviser is registered under the Advisers Act. See SEC Press Release 2007-133.

As a matter of principle, PFG and AGL support initiatives to protect investors. As noted previously, insurance companies and broker dealers are subject to a robust system of regulatory supervision and oversight. The SEC, through the rulemaking process, continues to refine these investor protection initiatives for private placement offerings. The current regime of federal securities laws and state insurance laws applicable to insurance companies and broker dealers is already in place to protect purchasers of private placement variable life insurance and annuity products. Adoption of the Proposed Rule, as drafted, could conceivably be duplicative of and in conflict with current federal securities rules and state insurance rules applicable to these types of products.

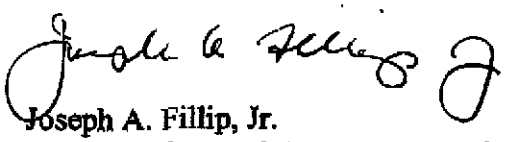
Conclusion

PFG and AGL submit that the Proposed Rule should not apply to private placements of variable life insurance and variable annuity products issued by a member or member affiliate or a "control entity" of a member. The definition of "control entity" should exclude insurance companies and insurance company separate accounts and other entities described as "Offerors" in Rule 2820. MPOs of "variable contracts" and MPOs offered

and sold to "accredited investors" should be exempted from the Proposed Rule. Offerings made pursuant to Section 4(2) of the Securities Act and offerings made in reliance on Regulation D under the Securities Act should also be exempted from the Proposed Rule.

We appreciate the opportunity to comment on the Proposed Rule and would be happy to discuss our comments further with the NASD should that be helpful.

Sincerely,



Joseph A. Fillip, Jr.
Vice President and General Counsel
PFG Distribution Company
Senior Vice President and General Counsel
AGL Life Assurance Company

July 20,2007

The International Association of Small Broker Dealers and Advisors
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The International Association of Small Broker-Dealers and Advisers,www.iasbda.com submits the following comments on one aspect of the above referenced proposed rule. The Rule requires members to use 85% of the proceeds of their own private offerings for the specific purposes described in the offering. We believe that the use of such a specific number appears to be inconsistent with the NASD'S expressed policy of principles based or tiered regulation. It is on its face one size fits all. It also seems to negate a firm's ability to adapt to changing circumstances after the offering is completed. We believe a better result is achieved by requiring a firm to specify in its disclosure whether it reserves the right to use more than 15% of the offering for other purposes due to changed circumstances and to describe in detail those purposes and circumstances. They should specifically address use of the proceeds for compensation if that is the cause of this rulemaking. Small firms may need more flexibility in this regard as they are more likely to be buffeted by sudden changes or presented with sudden opportunities. A small firm that completes an offering to improve its net capital or enhance its technology could then be presented with an opportunity to enter a new business by hiring a team from a competitor. It would seem that the use of 20% of the proceeds for that purpose would not be so bad and its not the same as using it to enlarge bonuses for current management. While the rule provides for an exemption, another way of achieving this flexibility would be to state the rule in terms of a presumption or a guideline rather than a strict prohibition. We believe that having the NASD staff decide on whether an additional 5% of an offering might be subsequently used to add a new business rather than to add to capital is not an efficient use of staff time or deployment of capital. We also worry that the exemptive process can often be time consuming and costly especially for a small firm.

Peter J. Chepucavage
General Counsel
Plexus Consulting
202-785-8940 ext 108.

SIFMA
Securities Industry and Financial Markets Association

July 27, 2007

Via E-mail: pubcom@nasd.com

Ms. Barbara Z. Sweeney
Office of the Corporate Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 2006-1506

Re: Proposed Rule 2721 Relating to Member Private Offerings

Dear Ms. Sweeney:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates this opportunity to comment on the above-referenced proposed rule (the "Proposal"), as published for comment through NASD Notice to Members 07-27 (the "NTM"). Capitalized terms used herein are defined in the Proposal, except as otherwise set forth herein.

1. Summary of the Proposal

Proposed Rule 2721(c) would generally require that the following disclosures be made in a private placement memorandum (a "PPM") relating to a Member Private Offering:

(1) the risk factors associated with the investment, including company risks, industry risks and market risks;

(2) intended use of the offering proceeds;

(3) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons; and

(4) any other information necessary to ensure that required information is not misleading.

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

In addition, pursuant to Proposed Rule 2721(d), the PPM must generally set forth that at least 85% of the offering proceeds raised in a Member Private Offering will be used as identified in the "intended use of the offering proceeds" disclosure of the PPM.

Proposed Rule 2721(b) would generally require that the applicable PPM must be filed with the NASD's Corporate Financing Department (the "Department") at or prior to the first time the PPM is provided to any investor. In addition, any amendment or exhibit to the PPM must generally be filed with the Department within 10 days of being provided to any investor. According to the Proposal, although the Department will not issue a "no-objections opinion" with respect to the filing of a PPM, if the NASD subsequently determines that the disclosures in the PPM "appeared to be incomplete, inaccurate or misleading", the NASD could "make further inquiries."

A Member Private Offering is defined in proposed Rule 2721(a)(1) to mean a "private placement" of "unregistered securities" issued by an NASD member or a "control entity"[2] in a transaction that is exempt from registration under (i) the Securities Act of 1933, as amended (the "Securities Act") and (ii) the filing requirements of NASD Rules 2710, 2720 and 2810.[3]

2. Scope of Proposal is Overbroad

The proposed disclosure requirements and the use of proceeds limitations of the Proposal would encroach upon the regulatory jurisdiction that Congress has specifically mandated to the Securities and Exchange Commission (the "SEC") under the Securities Act. In fact, as more fully discussed below, Congress, through the enactment of the National Securities Markets Improvement Act of 1996 ("NSMIA"), specifically removed the concurrent jurisdiction that the States had historically enjoyed under Section 18 of the Securities Act to regulate, among other things, the disclosure and substance of private offerings conducted pursuant to Rule 506 of Regulation D under the Securities Act. Moreover, the proposed disclosure requirements and the use of proceeds limitations of the Proposal go significantly beyond the more limited scope disclosures of the NASD's Corporate Financing rules that are applicable to public offerings made to retail investors. In addition, the Proposal seems to extend far beyond the concerns articulated by the NASD and would have the consequence of unfairly discriminating between Member Private Offerings and private, unregistered offerings by non-NASD members.

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[2] Pursuant to proposed Rule 2721(a)(2), a "control entity" means any entity that controls or is under common control with an NASD member, or that is controlled by such a member or its associated persons. The term "control" is defined for these purposes to mean the "beneficial ownership" of more than 50% of the outstanding "voting securities" of a "corporation", or the right to more than 50% of the distributable profits or losses of a "partnership."

[3] NASD Rules 2710, 2720, and 2810, which comprise the NASD's Corporate Financing rules, do not apply to, among other things, private offerings by an issuer which are exempt from registration under the Securities Act by reason of Section 4(2) thereunder, including by reason of the safe-harbor exemption set forth in Rule 506 of Regulation D thereunder. See NASD Rule 2710(b)(8)(A) (which also applies to the applicability of NASD Rule 2810) and NASD Rule 2720(a), including the definition of "public offering" in NASD Rule 2720(b)(14).

The Proposal would govern disclosures of offerings pursuant to, among other things, Rule 506 of the Securities Act. As noted above, however, Congress, in enacting NSMIA, substantially limited the concurrent jurisdiction of the States to regulate, among other things, Rule 506 offerings, and specifically preempted and prohibited State-mandated disclosure and merit review requirements as well as any other requirements relating to the "registration or qualification…directly or indirectly" in respect of, among other things, private offerings conducted pursuant to Section 4(2) of the Securities Act and Rule 506. Congress did so on the grounds that these types of "national offerings", and the regulation thereof, should be left to the SEC under the express authority granted by Congress under the Securities Act.[4] Through NSMIA, Congress conclusively eliminated the conflicting regulatory standards that had developed among the different States in respect of the disclosure and other requirements relating to private offerings. In this regard, pursuant to Rule 502(b) of the Securities Act, the SEC has specifically considered and mandated certain disclosures in private offerings conducted pursuant to Rule 506 under the Securities Act. Any disclosure required by the NASD could be in contradiction or opposition to what is specifically mandated by the SEC pursuant to its regulations, and therefore, is inappropriate.

As a policy matter, because the NASD derives its authority from Congress under the Exchange Act, and Congress has determined to limit all States and the U.S. territories from imposing potentially conflicting disclosure and other regulation on private offerings conducted pursuant to Rule 506 under the Securities Act, and to leave such regulation exclusively to the SEC, we believe, similarly, that Congress never intended that the NASD, or any other self-regulatory organization, should be able to impose what could also be potentially conflicting disclosure and other requirements on private offerings separately from the requirements/regulation imposed by the SEC under the Securities Act. If the NASD were unconstrained to impose disclosure and other requirements on private offerings, what would preclude any other self-regulatory organization (a "SRO") from doing the same and creating a potentially conflicting patchwork of regulation similar to that which arose with the States prior to the enactment of NSMIA? We are not aware of any statutory or other precedent that would suggest that the SEC has afforded a wholesale delegation of its regulatory authority to the NASD in this regard, or that such a delegation of authority would be permissible or desirable.

Member Private Offerings to sophisticated investors are adequately regulated by the SEC under the Securities Act. We do not believe that the involvement of, or affiliation with, an NASD member raises any unique aspects to such regulation that would require special consideration by the NASD. The NASD, of course, would still be able to supervise its members and bring enforcement actions as necessary if it were to determine that a member had violated the Securities Act or any other applicable laws. We believe that in consideration of this, the NASD has traditionally ceded oversight of "issuer information" (such as, private placement memoranda and prospectuses) under NASD Rule 2210 to the SEC.[5]

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[4] See Section 18(a)(1) and (b)(4) of the Securities Act.

[5] See letter from Lisa C. Horrigan, Assistant General Counsel, NASD to Eileen Ryan and Sarah Starkweather dated August 1, 2006 entitled "Free writing prospectuses are not subject to Rules 2210 and 2211 or the filing requirements of Rules 2710 and 2720." Specifically, the NASD states in such letter that "…as a matter of practice, NASD's

The Proposal would also have the counterintuitive effect of conferring upon the NASD broader disclosure authority in private offerings than it has in public offerings; yet, by reason of the constraints imposed under the Securities Act, private offerings are necessarily made to persons who are not retail (public) investors, but, instead, are sophisticated investors who are capable of "fending for themselves." Although NASD Rules 2710, 2720, and 2810 require certain disclosures in public offerings, those requirements are much more limited than the disclosures that would be required by the Proposal. The disclosure under those rules are limited to disclosures relating to the fairness of underwriting terms and arrangements or, in the case of NASD Rule 2810, are limited to certain specific types of offerings ("direct participation offerings" or "DPPs").[6] However, proposed Rule 2721(c) would permit the NASD to require an issuer to disclose "risk factors associated with the investment, including company risks, industry risks, and market risks" and "any other information necessary to ensure that required information is not misleading", and is not limited to disclosures relating to the fairness of offering terms and arrangements.

Furthermore, the need for regulation of disclosure in excess of what is required by public offerings is questionable as investors in private placements are by nature sophisticated parties who are able to understand their investments. In fact, there is implicit recognition of this principal by the NASD; presumably, the requirements of the NASD's Corporate Financing rules, including the disclosure requirements thereof, were not made applicable to offerings which are made on a private placement basis, such as Member Private Offerings, on the grounds that the restrictions/limitations implicit in Section 4(2) of the Securities Act, and Rule 506 thereunder, require that such offerings be conducted solely with sophisticated investors who can adequately protect their own interests and, thus, who do not need the protections afforded by the registration requirements of the Securities Act or the requirements of the Corporate Financing rules.[7]

Advertising Regulation Department does not apply any of the provisions of Rules 2210, including the content requirements, to issuer-created materials, such as prospectuses." NASD Rule 2210(d) prescribes certain fairness and content requirements in sales literature and advertisements used by NASD members in connection with, among other things, private securities offerings.

[6] NASD Rule 2710(c)(2)(C), for example, requires that all items of underwriting compensation be disclosed in the underwriting section of the applicable prospectus. NASD Rule 2710(h)(2) requires that, subject to certain exceptions, if more than 10% of net offering proceeds will be paid to participating NASD members and/or their affiliates, then the underwriting section of the applicable prospectus must disclose that the offering is being made pursuant to the provisions of NASD Rule 2710(g) and, if applicable, set forth the name of the NASD member which is acting as a qualified independent underwriter (the "QIU") as well as that such QIU is assuming the responsibility of acting as a QIU in the pricing of the offering and conducting due diligence in respect of such offering. NASD Rule 2720(d) requires certain limited-scope disclosures in the applicable prospectus where an NASD member acting as underwriter is an "affiliate" of the issuer or otherwise has a "conflict of interest" with such issuer, as such terms are defined in NASD Rule 2720. NASD 2810(b)(2)(A) and (3) require disclosures in the applicable prospectus relating to (i) the suitability standards employed in the offering of any "direct participation program" (a "DPP") and (ii) certain areas of disclosure relating to offerings of DPPs, respectively.

[7] Pursuant to Rule 506(b) under the Securities Act, the issuer must reasonably believe that an offering being conducted pursuant to Rule 506 must be made to not more 35 purchasers who do not qualify as "accredited investors", provided that each purchaser who is not an accredited investors is "sophisticated"; that is, each such

In addition, with respect to the use of proceeds requirements of the Proposal, the Proposal would provide the NASD with broad “merit review” authority that goes significantly beyond the scope of its jurisdiction as an SRO as conferred by Congress under Section 15A of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Even assuming NASD has jurisdiction and some regulation is desirable, the Proposal would sweep in and unnecessarily complicate many legitimate transactions that exceed the scope of what appears to be the NASD’s policy rationale for recommending the Proposal. The NASD states in the NTM, under the heading "Background and Discussion", that the Proposal arises from "numerous enforcement cases" concerning "abuses in connection with Member Private Offerings" as well as from "widespread problems" that the NASD discovered in connection with a sweep of members which had engaged in such offerings. However, the enforcement actions to which the NASD refers in endnote 3 to the NTM appear to be limited to smaller firms who sought to raise funds to finance their working capital/operations ("Financing Offerings").[8] The Proposal as drafted, however, would encompass many levels of private offerings, which technically qualify as Member Private Offerings, but that are not intended as a primary source of working capital for a member firm and/or are not Financing Offerings. Rather, these other types of offerings are intended and designed to provide specialized securities products to sophisticated investors, such as private placements of derivative products and collective investment vehicles. Because we see no indication by the NASD in the NTM that it has observed any disclosure or other irregularities or problems in connection with offerings that are not Financing Offerings, we believe that the Proposal is significantly overinclusive and, if the Proposal is to be considered, and should be narrowly tailored to encompass only Financing Offerings.

Finally, the Proposal, as drafted, would unfairly discriminate between Member Private Offerings and private, unregistered offerings by non-NASD members (“non-Member Private Offerings”). Non-Member Private Offerings would not be subject to NASD scrutiny

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purchaser must either alone or with a purchaser representative have such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of the prospective investment. Accredited investors are presumed to be sophisticated for these purposes. There is no numerical limitation on the number of purchasers who qualify as accredited investors.

[8] See also NASD Investor Alert dated June 14, 2004 entitled “Brokerage Firm Private Securities Offerings: Buying Your Brokerage” (the “Alert”). The Alert related to "private BDOs", to which the NASD states "[t]he money that brokerage firms raise in private BDOs is usually used to finance their operations or those of an affiliate. When you invest in a private BDO, you are investing in the brokerage firm itself or its affiliate. As such, you share in the risks that the business will be unsuccessful or unprofitable or you could participate in unsuccessful operations of the firm or its affiliates when the increased value of the firm or affiliate's equity is reflected in the value of the securities" and that “[i]nvesting in a private BDO can involve significant risk. And BDOs that are publicized through spam emails or cold calling are often fraudulent or otherwise problematic.” The latter focuses on capital raising initiatives. Moreover, the capital raising orientation of the Alert is further emphasized in the Alert under "Why are Private BDOs Risky?" - "The Brokerage Firm or the Affiliate Has a Conflict of Interest". In particular, the NASD notes in the latter discussion: "While brokers generally benefit when you buy any investment from them, this is particularly true for private BDOs where the firm or its affiliate gets all your money rather than just a commission. Find out why the brokerage firm wants to raise money."

whereas Member Private Offerings would be subject to the additional regulatory burdens and costs of complying with the filing and other requirements of the NASD under the Proposal. However, as noted above, we do not believe that Member Private Offerings raise any unique regulatory issues in respect of disclosure or other requirements that would warrant special consideration, or review, by the NASD. In fact, we believe that non-Member Private Offerings are subject to the same potential abuses in disclosure and use of proceeds as member Private Offerings. Thus, we believe that, as non-Member Private Offerings are deemed to be adequately regulated under the Securities Act as administered by the SEC - the law primarily designed to regulate securities offerings – similarly the Securities Act should solely govern Member Private Offerings.

Accordingly, we believe that the disclosure and use of proceeds requirements of the Proposal are not necessary and go significantly beyond the scope of the NASD's SRO regulatory mandate, as set forth in the Exchange Act. The assumption by the NASD of such broad disclosure and merit review authority in respect of private offerings would appear to run counter to the express mandate of Congress, which specifically sought to limit, not expand, the scope of State disclosure and review of private offerings through the enactment of NSMIA, and to leave the regulation of such offerings, such as disclosure and merit review authority, to the SEC under the Securities Act. In addition, the disclosure required by the Proposal is of arguable value given the sophisticated nature of the offerees, as required under the Securities Act, and given the implicit historical acknowledgment by the NASD in determining not to extend the coverage of its Corporate Financing rules to private offerings. The Proposal is also overinclusive and sweeps in transactions not subject to the concerns articulated by the NASD. It would also create a dichotomy of regulation between transactions without logical distinction (i.e., between Member Private Offerings and non-Member Private Offerings).

3. Specific Comments on the Proposal.

(a) Definition of Control Entity

We raise a number of questions and issues with respect to the definition of "control" under the Proposal. The term "control" for the purposes of the definition of "control entity" in proposed Rule 2721(a)(2) means the "beneficial ownership" of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership.

We believe that the definition of control for these purposes should be limited to the holders of more than 50% of the common stock of the corporation on the grounds that the common stock of a corporation will, generally, be the class of security with the broadest voting rights of any other class of security of such corporation. A corporation could have multiple classes of stock, such as common stock and preferred stock. Although common stock and preferred stock may each have voting rights, preferred stock is likely to have more limited voting rights than common stock. Similarly, while outstanding debt securities of an issuer may be the subject to certain "negative" consent rights that confer voting-type rights on the holders thereof

with respect to certain actions by the issuer, it is unlikely to have as significant voting rights as common stock.

We also ask that, in the case of an issuer which is not a corporation, the term "control" should mean the right to more than 50% of the distributable profits or losses of any legal entity. The definition of "control" appears to contemplate only issuers which are "corporations" or issuers which are "partnerships." However, issuers may also be, for example, a limited liability company, a business trust, or, if organized offshore, some other form of legal entity.

In addition, we request clarification that Member Private Offerings are not meant to encompass situations where, for example, a newly-formed hedge fund or CDO, prior to the first closing of the sale of the applicable issuer's securities, but during the initial marketing phase of the offering, may be technically wholly-owned, or more than 50% owned, by an affiliate of the issuer (which owner is, itself, affiliated with an NASD member), but after the initial closing would be expected to be more than 50% owned by unaffiliated (third party) investors. That is, the 50% beneficial ownership test should be applied on a post-transaction or closing basis. Furthermore, in light of what appears to be the narrow circumstances of Financing Offerings that the Proposal contemplates, as discussed above, we believe that the 50% test for a control entity should also require (i) that the ultimate parent company of the NASD member in question derive 50% or more of its gross revenues from the member or that such parent company derive 50% or more of its assets from such NASD member (see, for example, the definition of "parent" in NASD Rule 2720(b)(10)) and (ii) in order to avoid the application of the Proposal unnecessarily to offerings of collective investment vehicles where an NASD member, or any affiliate, does not directly exert management control over such vehicles, that an NASD member, or any affiliate thereof, must have management control over the issuer through the possession of the power to direct or cause the direction of the management or policies of the issuer. See also our additional comments below regarding whether hedge funds, private equity funds, CDOs, or CLOs should be subject to the Proposal in the first instance.

We also believe that the definition of "beneficial ownership" should follow NASD Rule 2790(i)(1) and that this definition should be specifically incorporated into proposed Rule 2721. The definition of "beneficial ownership", as used in the definition of "control entity", is not defined. We suggest that the NASD look to the definition of "beneficial interest" in NASD Rule 2790(i)(1), which specifically states that "[t]he receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, shall not be considered a beneficial interest in the account." Although endnote 7 to the NTM provides that the NASD will not include performance and management fees earned by "the general partner", we believe that the latter is too narrow and seems to, literally, contemplate the receipt of a performance and/or management by a general partner of a limited partnership and, thus, would not necessarily encompass the receipt of a management and/or performance fee by managers of other legal entities, such as limited liability companies or offshore entities.

Furthermore, we believe that a deferred compensation arrangement, as described in the paragraph above, should not count towards the 50% ownership threshold set forth in the definition of control entity. Endnote 7 to the NTM provides that if performance and management fees are subsequently re-invested "in the partnership", thereby increasing "the general partner's" ownership interest, then such interests would be considered in determining whether the "partnership is a control entity." The managers of many hedge funds, for example, defer the receipt of their management and/or performance fees for a specified period of time. Because those fees have been earned by the manager, the deferral of the payment of such fees to the manager becomes, or creates, an unsecured obligation of the hedge fund. Typically, the fund, but not the manager, will hedge its obligation by investing the deferred payments in the fund. This deferral does not increase the manager's equity "ownership" interest in the fund and therefore, should not be applied to the 50% ownership threshold.

(b) Disclosure Requirements

Proposed Rule 2721(c) generally provides that no NASD member or associated person may "participate" in a Member Private Offering unless a PPM, meeting certain mandated disclosures, is provided to each investor. As the Proposal does not define the term "participate", we seek clarification if the NASD intends to employ the definition of "participation" set forth in NASD Rule 2710(a)(5), which definition encompasses not just marketing, but also, among other things, such as "[p]articipation in the preparation of the offering or other documents." In this regard, we believe that the disclosure and other requirements of the Proposal, including the filing requirements thereof, should only apply if the issuer is marketing, or offering, its securities through its affiliated NASD member or any associated person thereof. Thus, it should not apply if, for example, the offering is placed through an unaffiliated NASD member. In such cases, the unaffiliated NASD member, acting as placement agent for the Member Private Offering, will act as an objective arbiter of the adequacy of the disclosure to prospective investors as well of the proposed business terms, such as the proposed use of proceeds of the offering.[9]

(c) Filing Requirements

We raise a number of questions regarding the filing requirements under the Proposal. Proposed Rule 2721(b) would generally require that no NASD member or associated person may offer or sell any security in a Member Private Offering, unless the applicable PPM has been filed with the Department at or prior to the first time the PPM is provided to any investors. In addition, any "amendment or exhibit" to such PPM must generally also be filed with the Department within 10 days of being provided to any investor. Proposed NASD Rule 2721(c), on the other hand, would generally require that no NASD member or associated person

[9] Pursuant to NASD Rule 2310, an NASD member has a suitability obligation to a customer before it can recommend the purchase of any security to such customer. Pursuant to NASD Notice to Members 03-07, NASD members must generally discharge two forms of suitability: reasonable-basis suitability and customer-specific suitability. With respect to reasonable-basis suitability, an NASD member must undertake appropriate due diligence to understand the terms of the specific offering. NASD members acting as placement agents in private offerings also have powerful economic incentives pursuant to Rule 10b-5 under the Exchange Act to ensure that the applicable PPM contains all material disclosures and is not misleading.

may "participate" in a Member Private Offering unless the applicable PPM is provided to each investor, which PPM must disclose certain required information.

We suggest that the requirement triggering filing with the NASD under proposed NASD Rule 2721(c) should be limited to when an offering is conducted through, or by, an affiliated NASD member or any associated person thereof, and not just in connection with the broader "participation" by a member thereof. There appears to be an inconsistency between the filing requirement of proposed Rule 2721(b) and the disclosure requirements of proposed Rule 2721(c) in that the disclosure requirements in respect of the PPM appear to be intended to apply when the PPM is required to be filed with the Department; that is, when the offering is being made through an NASD member or associated person thereof. However, the disclosure requirement triggers with the broader "participation" of an NASD member or any associated person thereof, which could include a situation where the NASD member is involved in preparing the document, rather than when the NASD member is involved in the sale or offer of the securities.

We seek clarification from the NASD as to the method by which filing with the Department would be accomplished. Does the Department propose that filings under the Proposal to be effected through the NASD's CobraDesk? As a practical consideration, we expect that the volume of filings that would be required under the Proposal, as drafted, would be considerable and query whether the NASD has the necessary infrastructure and personnel in place to adequately process, and review, such filings.

In addition, we believe that preliminary term sheets, pitch books and sales brochures that may be used, and which may accompany, the PPM (which materials would likely be deemed by the NASD to constitute "sales literature" under NASD Rule 2210 and thus subject to the fairness and content requirements thereof), should not be subject to the filing and other requirements of the Proposal. As noted above, proposed NASD Rule 2721(b) would require not only the filing of the PPM with the NASD, but also the filing of any "amendment or exhibit" to the PPM. Because NASD Rule 2210(d) already regulates the fairness and content of "sales literature" (which is defined in NASD Rule 2210(a)(2) to mean "any written or electronic communication" that is "generally distributed or made generally available to customers"), we believe that additional regulation regarding such documents is not necessary and could be duplicative or potentially contradictory.

Furthermore, we believe that only a single filing, covering all placement agents, current and prospective, should be required for any offering. Proposed Rule 2721(b) would generally appear to require that each NASD member, or associated person, acting as a placement agent in respect of a Member Private Offering perfect a separate filing with the Department. We believe that separate filings for each placement agent would be redundant, time-consuming and expensive, and would not provide additional information to the NASD. In addition, we note that in public offerings, pursuant to the NASD's Corporate Financing rules, only the lead underwriter is required to file the offering document.

We also recommend that the NASD require that a no-objections letter be issued within 2 business days after the filing of the PPM, any amendment or exhibit thereto, with the Department. Although, the Proposal states that the NASD will not be issuing any form of "no-objections opinion" in connection with a filing under proposed NASD Rule 2721, the NASD does state that it may make "further inquiries" if, "subsequently", the NASD has "determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading." As a practical matter, we do not believe that an issuer or NASD member/selling agent will elect to commence a Member Private Offering without a formal "no-objections opinion" from the NASD because of the potential liability concerns if the NASD were to subsequently "determine" that any of the disclosures in the PPM were "incomplete, inaccurate or misleading." Thus, a time period for issuance of no-objections letter is crucial in order to prevent undue delay of offerings.

Additionally, notwithstanding endnote 8 to the Proposal, which states that the NASD may create a "database of MPO activity," we urge the NASD to keep such information confidential. Much of the information that may be set forth in any PPM, amendment, or exhibit, will likely be proprietary and sensitive information. We believe, by analogy to NASD Rule 2710(b)(3), that the NASD should specifically provide that the NASD shall accord confidential treatment to all documents and information filed with the Department pursuant to the proposed Rule 2721, and that the NASD shall utilize such documents and information solely for the purpose of review to determine compliance with the requirements of such proposed rule. In addition, the broad availability of such information could interfere with an issuer's obligation to control the dissemination of offering materials and not engage in general advertising or general solicitation.[10]

(d) Use of Offering Proceeds

We raise a number of questions and comments regarding the use of proceeds requirement in the Proposal. Proposed Rule 2721(d) would generally require that at least 85% of the offering proceeds of a Member Private Offering be used for the business purposes identified in the PPM. Offering and other expenses of the offering could not exceed 15% of the offering proceeds, which the NASD notes in the Proposal is "consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810."

As noted above, we do not believe it is appropriate for the NASD to impose a 15% or any other limitation on the amount of offering fees and expenses on the grounds that private offerings conducted in accordance with Section 4(2) of the Securities Act and/or Rule 506 thereunder are necessarily offered only to sophisticated investors who can negotiate their own terms and appropriately "fend for themselves."

However, if such regulation is determined to be appropriate, we note that "selling compensation" under the Proposal is not defined. We first ask whether the NASD intends to model the "selling compensation" definition pursuant to NASD Rule 2710(c)(2) and (d)(1),

[10] See Rule 502(c) under the Securities Act.

which govern public offerings. In such context, selling compensation includes all "items of value" received or to be received by an NASD member any related person thereof "from any source" during the 180-day period preceding the date of the applicable offering document as well as received during the 90-day post-offering period (see NASD Rule 2710(b)(6)(A)(vi)(b)). If this rule is to be the model for the definition of "selling compensation" under the Proposal, we believe that in the context of a private offering, a 180-day "look back" period and a 90-day "look forward" period is not appropriate. Rather, there should not be any aggregation of items of value for the purposes of the 15% total compensation requirement of proposed NASD Rule 2721(d), if such items of value were received by the issuer or any related person more than 30 days prior to commencement of the Member Private Offering or received at any time after the commencement of such offering, provided that the arrangement to receive any post-offering item of value was not entered into during the 30 days preceding the commencement of the Member Private Offering. 30 days appears to be the market standard that has evolved as an integration safe harbor under Regulation D.[11] Also, the exceptions from "item of value" set forth in NASD Rule 2710(c)(3)(B) should be included into the proposed Rule 2721.

In addition, we believe that the 15% total compensation requirement of proposed NASD Rule 2721(d) should not include trail commissions paid to registered representatives of an NASD member in connection with a Member Private Offering that is a commodity pool where such registered representatives (i) have passed either the National Commodity Futures Examination (Series 3) or the Futures Managed Funds Examination (Series 31) and (ii) provide ongoing investor relations to investors, and the NASD member with which the representative is registered is registered with the Commodity Futures Trading Commission as a Futures Commission Merchant.[12] Such treatment would be in line with the arrangement determined in connection with the NASD's treatment of trail commissions in public offerings. Prior to 2004, trail commissions paid to Series 3/31 registered personnel were not included towards the 15% compensation limitation of NASD Rule 2810. When the NASD withdrew that prior interpretation and began including trail commissions in the determination of the 15% compensation limits, it was not intended that any such restrictions would apply in the context of private offerings. In contradiction to the previous arrangement, proposed NASD Rule 2721 would appear to impose regulation of the payment of trail commissions in private offerings.

(e) Exemptions

In addition to the exemptions set forth in proposed Rule 2721(e), we believe that the following should also be exempt from the application of the Proposal:

- offerings made to "accredited investors", as defined in Rule 501(a) of Regulation D under the Securities Act. In connection with an offering conducted pursuant to Section 4(2) of the Securities Act and Rule 506

[11] See Lamp Technologies, Inc., NO-ACT, NAFT WSB File No. 060297002 (publicly available May 29, 1997).

[12] See NASD Notice to Members 04-50.

thereunder, the latter would mean that the Proposal would apply only to offerings made to non-accredited investors – presumably the types of offerings referred to in endnote 3 of the NTM for which the NASD was concerned.

- offerings by an NASD member or control entity which is either a reporting company pursuant to the Exchange Act, a consolidated subsidiary of such a reporting company or a company whose securities are guaranteed by a reporting company because sufficient public disclosure regarding the issuer and its affiliates and the guarantor will already be available in the marketplace.

- offerings of financial derivatives, such as over-the-counter ("OTC") options which are derivative of, or based upon, a security issued by an unaffiliated issuer. In a derivative transaction, the seller of the derivative, such as an OTC option could be deemed to be the "issuer" of such option, although such issuer is not issuer of the underlying security upon which the derivative is economically based. We do not believe that the NASD intended the Proposal to apply to such "offerings." The "issuer" of the OTC derivative, such as an OTC option, is not the issuer, and may not be related to the issuer, of the underlying security, and the economic value of the derivative derives solely from the value of the underlying security in question. Even if the underlying security was issued by an affiliated entity of the "issuer" of the derivative instrument, because such underlying security would have been previously issued, and thus would be issued and outstanding, we do not believe that the NASD intended that the Proposal apply thereto as well. That is, private transactions involving equity derivatives should be viewed as secondary market transactions and not as primary market transactions that are contemplated by the Proposal.

- offerings of structured notes; warrants; asset-backed securities (broadly defined to include securities collateralized by financial assets, leases, other property, and synthetic or other risk-transfer securities; CDOs and CLOs); hedge funds; private equity funds; and financial products offered by affiliated (and regulated) banks (and bank operating subsidiaries) of an NASD member, as these offerings are specialized products that are not linked to the business or operations of such NASD member and are already subject to specifically tailored disclosure standards appropriate for the investment product offered.

- offerings of commodity pools which are operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act which offerings are substantively regulated by the Commodity Futures Trading Commission. This is in line with the comparable exception to the definition of "new issue" in NASD Rule 2790(i)(9)(C).

- given the scope of the NASD's articulated concerns, offerings that are not Financing Offerings, and de minimis Financing Offerings from which the NASD member derives 5% or less of its net worth, calculated based on its financial results for its last quarter and in accordance with Generally Accepted Accounting Principles (or any other financial standard accepted by the SEC).

- exchange offers because these transactions generally involve restructuring or similar extraordinary events with pre-existing security holders and are not the types of capital raising offerings contemplated by the Proposal.

- the Proposal provides for an exemption for offerings to "employees and affiliates of the issuer", but not to employees of affiliates of the issuer. Because employees of the issuer as well as affiliates of the issuer have access to multiple sources of information about the issuer and any offering thereby, we believe that the exemption for offerings to employees should be broadened to encompass employees of the issuer and any affiliate of the issuer. In addition, we recommend that the NASD provide an exemption for employee-related offerings by an issuer conducted pursuant to Rule 701 under the Securities Act.

- offerings of securities that have a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof, if they are offered pursuant to Section 4(2). Such securities are sold to sophisticated investors and, given the short-term nature of such offerings, are unlikely to present the issues that the NASD states as its concern. In addition, we note that the Proposal already excludes offerings of short-term securities exempt under Section 3(a)(3) of the Securities Act.

- offerings exempt from registration pursuant to Section 3(a) of the Securities Act on the grounds that these would constitute specialized offerings by regulated issuers or under specified circumstances that would not, in either case, involve the type of Financing Offerings to which the Proposal is addressed.

None of the specialized offerings above represent that type of capital raising contemplated by the NASD in endnote 3 to the NTM.

Furthermore, notwithstanding the requirement that an offering must be sold "solely to" the enumerated categories of investors under paragraph (e)(1) of proposed Rule 2721, we seek clarification that a single offering by an issuer may be made to any of the categories set forth therein, or in any combination thereof, and that an issuer may, in any single offering, combine exemptions under paragraph (e) to qualify for an "exemption" from the requirements of the Proposal.

Finally, we believe that the NASD should not apply proposed Rule 2721 to any offering which commenced prior to the effective date of such rule.

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We appreciate this opportunity to comment on the Proposal. If you have any questions concerning these comments, or would like to discuss these comments further, please feel free to contact me at 646.637.9220 or via email at mkuan@sifma.org.

Sincerely,

Mary Kuan
Managing Director and
Assistant General Counsel

July 20, 2007

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1506

RE: NTM 07-27; Proposed Rule 2721

Dear Ms. Sweeney:

Stephens Inc. ("Firm") appreciates the opportunity to comment on the NASD's proposal to adopt a new rule to be designated as Rule 2721.

The Firm recommends that the exemption described under proposed Rule 2721(e)(7) be expanded to exempt a Member Private Offering (MPO) made to employees of the Member or of its Control Entities (as defined in the proposed Rule), rather than limiting the exemption for offerings to employees to those MPO's made only to the employees of the *issuer*.

An affiliate of our Firm conducts a merchant banking business and, as a part of that business, regularly forms new investment entities (NIE's) for the purpose of investing in a particular company or engaging in a specific investment activity. Typically, these NIE's have no employees per se. The business of these NIE's is typically managed by employees of the merchant bank. However, in some cases, the merchant bank may wish to give selected employees of the merchant bank or selected employees of the Firm or of another Control Entity of the Firm an opportunity to participate in the investments of an NIE by permitting such employees to invest in the NIE. These selected employees are typically management or professional employees of the Firm or Control Entity. As a rule, these NIE's have no investors other than Control Entities of the Firm and, in some cases, employees of the Firm or of Control Entities of the Firm.

As we understand the proposed rule, an investment in such an NIE by such employees would constitute an MPO. Our Firm believes that employees of the Firm would be expected to have access to a similar level of information about these NIE issuers and their securities as the employees of other types of issuers would be expected to have about their employer/issuer and its securities. Similarly, since both the Firm and Control Entities of the Firm would also be affiliates of the issuer (which typically would have no employees), our Firm believes that employees of the Control Entities of the Firm would also be expected to have access to a sufficient level of information about the issuer and its securities.

Accordingly, we recommend that the exemption described under proposed Rule 2721(e)(7) be expanded to exempt an MPO made to employees of the Member or of its Control Entities, rather than limiting the exemption under proposed Rule 2721(e)(7) to those MPO's made only to the employees of the issuer.

Thank you for your consideration of our comments.

Yours truly,
Bill Keisler

Bill Keisler
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