OMB APPROVAL	
OMB Number:	3235-0045
Expires:	June 30, 2010
Estimated average burden hours per response	38

Page 1 of 50

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

File No. SR - 2008 - 020
Amendment No. 2

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).

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 01/07/2009

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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") Amendment No. 2 to SR-FINRA-2008-020, 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) disclose to investors in a private placement memorandum, term sheet or other offering document the intended use of offering proceeds and the offering expenses, (2) file such offering document with FINRA, and (3) commit that at least 85 percent of the offering proceeds will be used for business purposes, which shall not include offering costs, discounts, commissions and any other cash or non-cash sales incentives.

This Amendment No. 2 to SR-FINRA-2008-020 makes minor changes to the original filing filed on September 11, 2008.[2] The proposed rule change replaces and supersedes the proposed rule change filed on September 11, 2008 in its entirety, except with regard to Exhibit 2, NASD Notice to Members 07-27 and comments received in response to NASD Notice to Members 07-27.

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

---

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

2 Amendment No. 1 to SR-FINRA-2008-020, which was filed on December 22, 2008, was withdrawn on January 7, 2009.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5120. Offerings of Members' Securities

* * * * *

5122. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering

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

(2) Control Entity

A "control entity" means any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons.

(3) Control

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

(4) Private Placement

The term "private placement" means 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) Disclosure Requirements

(A) If an offering has a private placement memorandum or term sheet, then such memorandum or term sheet must be provided to each prospective investor and must contain disclosures addressing:

(i) intended use of the offering proceeds; and

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

(B) If an offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that contains the disclosures required in subparagraph (b)(1)(A)(i) and (ii) and provide such document to each prospective investor.

(2) Filing Requirements

A member must file the private placement memorandum, term sheet or such other offering document with the Corporate Financing Department at or prior to the first time the document is provided to any prospective investor. Any

amendment(s) or exhibit(s) to the private placement memorandum, term sheet or other offering document also must be filed with the Department within ten days of being provided to any investor or prospective investor.

(3) Use of Offering Proceeds

For each Member Private Offering, at least 85% of the offering proceeds raised must be used for business purposes, which shall not include offering costs, discounts, commissions or any other cash or non-cash sales incentives. The use of the offering proceeds also must be consistent with the disclosures required in paragraph (b)(1).

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 (see NASD Notice to Members 02-32 (June 2002));

(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 Rule 5110(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 Rule 5110 or NASD Rules 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.

• • • Supplementary Material: ----------

.01. Private Placement Memorandum. Nothing in this rule shall require a member to prepare a private placement memorandum. A member may satisfy the disclosure and filing requirements in the Rule with an offering document that does not meet the additional requirements of Securities Act Rule 502.

* * * * *

(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.[3] Among the allegations in these cases were that members failed to provide written offering documents to investors, or provided offering documents 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

---

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, FINRA has numerous ongoing investigations involving MPOs.

4 FINRA Rule 5110 and NASD Rules 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

---

5 Members would remain subject to other FINRA rules that govern a member's participation in the offer and sale of a security, including FINRA Rules 2010 and 2020 and NASD 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." The term "control" is defined as "a beneficial interest, as defined

---

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.

in Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity."[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.

---

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.

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 have revised the definition of control to be determined immediately after the closing of an offering. The definition also clarifies that, in the case of multiple closings, control will be determined immediately after each 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").

Disclosure Requirements

The proposed rule change would require that a member provide a written offering document to each prospective investor in an MPO, whether accredited or not, and that the offering document disclose the intended use of offering proceeds as well as offering expenses and selling compensation.[13] If the offering has a private placement memorandum or term sheet, then such memorandum or term sheet must be provided to each prospective investor and must contain these disclosures. If the offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that discloses the intended use of offering proceeds as well as offering

---

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

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

expenses and selling compensation. The Rule is not meant to require a particular form of disclosure; to emphasize this point, we propose to issue Supplemental Material 5122.01, which would note that nothing in the Rule shall require a member to prepare a private placement memorandum that meets the additional requirements of Securities Act Rule 502.

FINRA believes that every investor in an MPO should receive basic information concerning the offering. We also believe that none of the disclosures required in the proposed rule change would conflict with requirements under federal or state securities laws.[14]

In response to comments,[15] 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 disclosure of 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 differed from the expectations of the SEC and the courts.[16] While we have omitted these disclosures from the proposed rule change, we specifically request comment on our decision to exclude such disclosures.

Filing Requirements

The proposed rule change would require that a member file a private placement memorandum, term sheet or other offering document with the Department at or prior to

---

14 See SIFMA letter.

15 See ABA letter.

16 See ABA letter.

the first time such document is provided to any prospective investor. Any amendments or exhibits to the offering document also must be filed by the member with the Department within ten days of being provided to any investor or prospective investor. The filing requirement is intended to allow the Department to identify those offering documents 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 Rule 5110 (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,[17] 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 explicitly clarifying this position.[18] The Department plans to develop a web-based filing system that would allow for the filing to be deemed filed upon submission.[19] In addition, the proposed rule change would not impose any additional requirements regarding filing

---

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

18 See 5122(d). This confidential treatment provision is similar to that provided in Rule 5110(b)(3).

19 As noted supra, and in NTM 07-27, neither FINRA nor the Department would issue a "no objections opinion" regarding any offering document filed with the Department. However, if FINRA subsequently determined that disclosures in the offering document 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.

of advertisements or sales materials, which would continue to be governed by NASD Rule 2210.[20]

One commenter suggested that a member's filing of Form D pursuant to Securities Act Regulation D should provide sufficient information to FINRA.[21] FINRA staff disagrees. For example, we note that the information in Form D does not include information on a wide variety of expenses or applications of proceeds, nor does Form D require that such information is contained in the offering documents.

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 business purposes, which would not include offering costs, discounts, commissions or any other cash or non-cash sales incentives. The use of offering proceeds also must be consistent with the disclosures to investors, as described above. 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. The proposed rule change 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 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

---

20 See NYC Bar letter; SIFMA letter.

21 See Mallon & Johnson letter.

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] FINRA 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 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 offering document 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 that offering's offering document. 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

---

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.

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;[25]
- offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);

---

[25] Members' offerings of subordinated loans are subject to an alternative disclosure regime. In 2002, the SEC approved a rule change to require, as part of a subordination agreement, the execution of a Subordination Agreement Investor Disclosure Document. See Exchange Act Release No. 45954 (May 17, 2002), 67 FR 36281 (May 23, 2002); see also Notice to Members 02-32 (June 2002).

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

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

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

- offerings filed with the Department under Rule 5110 or NASD Rules 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.[26] We clarified that exempted securities, as defined by Section 3(a)(12) of the Exchange Act, would not be subject to the Rule.[27] In addition, we propose an exemption for commodity

---

[26] 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.

[27] 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.

pools[28] 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[29] would be excluded, because the offer and sale of these types of offerings are already subject to existing FINRA rules.[30] We also propose an exemption for member private offerings that are filed with the Department under Rule 5110 or NASD Rules 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.[31] 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.[32]

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 control entities.[33] 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

---

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

29 See CAI letter; PFG letter.

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

31 See MGL letter; SIFMA letter.

32 See Mallon & Johnson letter.

33 See SIFMA letter.

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.[34]

Based on the comment letters,[35] 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.[36]

---

34 See Stephens letter; see also Lombard letter.

35 See ChoiceTrade letter; PFG letter; SIFMA letter.

36 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,[37] an investment fund[38] or a state or federal bank affiliate of a FINRA member[39] 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.[40] 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.

---

37 See ABA letter; SIFMA letter.

38 See MFA letter.

39 See Anders letter; ABA letter.

40 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,[41] 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.

---

41 15 U.S.C. 78o–3(b)(6).

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[42]

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. (See original filing dated September 11, 2008).

Exhibit 4. Text of the proposed rule change marked to show changes to text in original filing dated September 11, 2008.

---

[42] 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") and amended on ----------[3] 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) disclose to investors in a private placement memorandum, term sheet or other offering document the intended use of

---

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

2 17 CFR 240.19b-4.

3 Amendment No. 2 to SR-FINRA-2008-020. (This amendment replaced and superseded the original filing submitted to the SEC on September 11, 2008. Amendment No. 1, which was filed on December 22, 2008, was withdrawn on January 7, 2009.)

offering proceeds and the offering expenses, (2) file such offering document with FINRA, and (3) commit that at least 85 percent of the offering proceeds will be used for business purposes, which shall not include offering costs, discounts, commissions and any other cash or non-cash sales incentives.

Amendment No. 2 to SR-FINRA-2008-020 makes minor changes to the original filing filed on September 11, 2008. The proposed rule change replaces and supersedes the proposed rule change filed on September 11, 2008 in its entirety, except with regard to Exhibit 2, NASD Notice to Members 07-27 and comments received in response to NASD Notice to Members 07-27.

The text of the proposed rule change is available on FINRA's Web site at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

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.[4] Among the allegations in these cases were that members failed to provide written offering documents to investors, or provided offering documents 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

---

[4] 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, FINRA has numerous ongoing investigations involving MPOs.

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.[5] 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.[6]

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.[7] The comments were varied. Some commenters expressed support for the

---

5 FINRA Rule 5110 and NASD Rules 2720 and 2810 govern member participation in public offerings of securities.

6 Members would remain subject to other FINRA rules that govern a member's participation in the offer and sale of a security, including FINRA Rules 2010 and 2020 and NASD 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.

7 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

intent of the proposed rule, but voiced concerns about its breadth and scope;[8] others questioned the benefit or necessity of the proposed rule.[9] Most comment letters also suggested edits to the proposed rule.[10] 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

---

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).

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

9 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.

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

comment,[11] 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." The term "control" is defined as "a beneficial interest, as defined in Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity."[12] 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

---

11 See ABA letter; SIFMA letter.

12 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.

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,[13] we have revised the definition of control to be determined immediately after the closing of an offering. The definition also clarifies that, in the case of multiple closings, control will be determined immediately after each 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").

Disclosure Requirements

The proposed rule change would require that a member provide a written offering document to each prospective investor in an MPO, whether accredited or not, and that the offering document disclose the intended use of offering proceeds as well as offering expenses and selling compensation.[14] If the offering has a private placement memorandum or term sheet, then such memorandum or term sheet must be provided to

---

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

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

each prospective investor and must contain these disclosures. If the offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that discloses the intended use of offering proceeds as well as offering expenses and selling compensation. The Rule is not meant to require a particular form of disclosure; to emphasize this point, we propose to issue Supplemental Material 5122.01, which would note that nothing in the Rule shall require a member to prepare a private placement memorandum that meets the additional requirements of Securities Act Rule 502.

FINRA believes that every investor in an MPO should receive basic information concerning the offering. We also believe that none of the disclosures required in the proposed rule change would conflict with requirements under federal or state securities laws.[15]

In response to comments,[16] 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 disclosure of 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 differed from the expectations of the SEC and the courts.[17] While we have omitted these disclosures from the proposed rule change, we specifically request comment on our decision to exclude such disclosures.

---

15 See SIFMA letter.

16 See ABA letter.

17 See ABA letter.

Filing Requirements

The proposed rule change would require that a member file a private placement memorandum, term sheet or other offering document with the Department at or prior to the first time such document is provided to any prospective investor. Any amendments or exhibits to the offering document also must be filed by the member with the Department within ten days of being provided to any investor or prospective investor. The filing requirement is intended to allow the Department to identify those offering documents 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 Rule 5110 (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,[18] 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 explicitly clarifying this position.[19] The Department plans to develop a web-based filing system that would allow for the filing to be deemed filed upon submission.[20] In addition, the proposed rule change would not impose any additional requirements regarding filing

---

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

19 See 5122(d). This confidential treatment provision is similar to that provided in Rule 5110(b)(3).

20 As noted supra, and in NTM 07-27, neither FINRA nor the Department would issue a "no objections opinion" regarding any offering document filed with the Department. However, if FINRA subsequently determined that disclosures in the offering document 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.

of advertisements or sales materials, which would continue to be governed by NASD Rule 2210.[21]

One commenter suggested that a member's filing of Form D pursuant to Securities Act Regulation D should provide sufficient information to FINRA.[22] FINRA staff disagrees. For example, we note that the information in Form D does not include information on a wide variety of expenses or applications of proceeds, nor does Form D require that such information is contained in the offering documents.

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 business purposes, which would not include offering costs, discounts, commissions or any other cash or non-cash sales incentives. The use of offering proceeds also must be consistent with the disclosures to investors, as described above. 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. The proposed rule change 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 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

---

21 See NYC Bar letter; SIFMA letter.

22 See Mallon & Johnson letter.

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[23] and should be reduced or eliminated to allow flexibility for management in MPOs.[24] FINRA 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 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 offering document 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.[25] 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 that offering's offering document. 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

---

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

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

25 See NYC Bar letter.

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;[26]
- offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);

---

[26] Members' offerings of subordinated loans are subject to an alternative disclosure regime. In 2002, the SEC approved a rule change to require, as part of a subordination agreement, the execution of a Subordination Agreement Investor Disclosure Document. See Exchange Act Release No. 45954 (May 17, 2002), 67 FR 36281 (May 23, 2002); see also Notice to Members 02-32 (June 2002).

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

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

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

- offerings filed with the Department under Rule 5110 or NASD Rules 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.[27] We clarified that exempted securities, as defined by Section 3(a)(12) of the Exchange Act, would not be subject to the Rule.[28] In addition, we propose an exemption for commodity

---

27 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.

28 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.

pools[29] 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[30] would be excluded, because the offer and sale of these types of offerings are already subject to existing FINRA rules.[31] We also propose an exemption for member private offerings that are filed with the Department under Rule 5110 or NASD Rules 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.[32] 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.[33]

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 control entities.[34] 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

---

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

30 See CAI letter; PFG letter.

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

32 See MGL letter; SIFMA letter.

33 See Mallon & Johnson letter.

34 See SIFMA letter.

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.[35]

Based on the comment letters,[36] 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.[37]

Additionally, it is our view that financial products offered by a public reporting company,[38] an investment fund[39] or a state or federal bank affiliate of a FINRA member[40]

---

35 See Stephens letter; see also Lombard letter.

36 See ChoiceTrade letter; PFG letter; SIFMA letter.

37 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).

38 See ABA letter; SIFMA letter.

39 See MFA letter.

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.[41] 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.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[42] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote

---

40 See Anders letter; ABA letter.

41 See SIFMA letter.

42 15 U.S.C. 78o–3(b)(6).

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.

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 Elizabeth M. Murphy, 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. 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.[43]

Elizabeth M. Murphy

Secretary

---

[43] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the changes to previously filed rule language as proposed in Amendment No. 2. The changes proposed in the initial filing are shown as if previously adopted, and the new language proposed in Amendment No. 2 is underlined; proposed deletions in Amendment No. 2 are bracketed.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5120. Offerings of Members' Securities

* * * * *

5122. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering

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

(2) Control Entity

A "control entity" means a[A]ny entity that controls or is under common control with a member, or that is controlled by a member or its associated persons.

(3) Control

The term "control" [for purposes of this Rule] means beneficial interest, as defined in [NASD] Rule [2790]5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity. Control will be determined immediately after the closing of an offering, and i[I]n the case of an offering with multiple intended closings[, control will be determined at the first closing], immediately following each closing.

[(3)](4) Private Placement

The term "private placement" means a[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) Disclosure[Filing] Requirements

(A) If an offering has a[A] private placement memorandum or term sheet, then such[must be filed with the Corporate Financing Department ("Department") at or prior to the first time the private placement] memorandum or term sheet[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 must contain disclosures addressing[the private placement memorandum must disclose]:

[(A)](i) intended use of the offering proceeds; and

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

(B) If an offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that contains the disclosures required in subparagraph (b)(1)(A)(i) and (ii) and provide such document to each prospective investor.

(2) Filing Requirements

A member must file the private placement memorandum, term sheet or such other offering document with the Corporate Financing Department at or prior to the first time the document is provided to any prospective investor. Any amendment(s) or exhibit(s) to the private placement memorandum, term sheet or other offering document also must be filed with the Department within ten days of being provided to any investor or prospective investor.

(3) Use of Offering Proceeds

[At]For each [time a] Member Private Offering [is closed], at least 85% [percent] of the offering proceeds raised must be used for [the] business purposes, which shall not include offering costs, discounts, commissions or any other cash

or non-cash sales incentives. The use of the offering proceeds also must be consistent with the disclosures required in paragraph (b)(1). [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 (see NASD Notice to Members 02-32 (June 2002));

(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 5110[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 Rule 5110 or 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.

• • • Supplementary Material: ----------

.01. Private Placement Memorandum. Nothing in this rule shall require a member to prepare a private placement memorandum. A member may satisfy the disclosure and filing requirements in the Rule with an offering document that does not meet the additional requirements of Securities Act Rule 502.