

OMB APPROVAL

OMB Number: 3235-0045
 Expires: August 31, 2011
 Estimated average burden
 hours per response.....38

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

File No.* SR - 2011 - * 057

Amendment No. (req. for Amendments *)

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) * ☐

Rule

Pilot ☐ Extension of Time Period
 for Commission Action * ☐ Date Expires *

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 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, required when Initial is checked *).

Proposed Rule Change to Adopt New FINRA Rule 5123 (Private Placements of Securities)

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 10/04/2011

By Marc Menchel
 (Name *)

Executive Vice President and 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.

Marc Menchel, marc.menchel@finra.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information (required)

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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 (required)

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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

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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

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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”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt new FINRA Rule 5123 (Private Placements of Securities). Generally, as discussed further below, proposed FINRA Rule 5123 would require that members and associated persons that offer or sell applicable private placements (as described in the Rule), or participate in the preparation of private placement memoranda (“PPM”), term sheets or other disclosure documents in connection with such private placements, provide relevant disclosures to each investor prior to sale describing the anticipated use of offering proceeds, and the amount and type of offering expenses and offering compensation. Rule FINRA 5123 also would require that the PPM, term sheet or other disclosure document, and any exhibits thereto, be filed with FINRA no later than 15 calendar days after the date of the first sale, and any material amendments to such document, or any amendments to the disclosures mandated by the Rule, be filed no later than 15 calendar days after the date such document is provided to any investor or prospective investor, as discussed further below.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on April 14, 2011, the FINRA Board of Governors authorized the

¹ 15 U.S.C. 78s(b)(1).

filing of the proposed 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 90 days following Commission approval. The implementation date will be no later than 180 days following Commission approval.

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

(a) Purpose

FINRA is proposing to adopt new Rule 5123 (Private Placements of Securities) to ensure that investors in private placements are provided detailed information about the intended use of offering proceeds, the offering expenses and offering compensation. In addition, new Rule 5123 would provide FINRA, through a member “notice” filing requirement, with more timely and detailed information about the private placement activities of member firms.

Rule 5123(a) would prohibit a member or person associated with a member from offering or selling any security conducted in reliance on an available exemption from registration under the Securities Act (“private placement”), or participating in the preparation of a PPM, term sheet or other disclosure document for such private placement, unless the member or associated person provides a PPM or term sheet to each investor prior to sale that describes the anticipated use of offering proceeds, the amount and type of offering expenses, and the amount and type of compensation provided or to be provided to sponsors, finders, consultants and members and their associated persons in connection with the offering, or, in private placements without a PPM or term sheet,

preparing a document that contains these disclosures and providing it to each investor prior to sale.

Proposed Rule 5123(b) would require “notice” filings of members’ private placement activities. Specifically, the proposed Rule would require participating members to file the PPM, term sheet or other disclosure document (including exhibits) with FINRA no later than 15 calendar days after the date of first sale, and to file any material amendments to such document, or any amendments to the disclosures mandated by the Rule, with FINRA no later than 15 calendar days after the date such document is provided to any investor or prospective investor.

Proposed Rule 5123(c) would exempt from the requirements of the Rule several types of private placements. Exemptions include offerings sold only to any one or more of the following purchasers:

- institutional accounts, as defined in NASD Rule 3110(c)(4);²
- 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;

² The SEC approved SR-FINRA-2010-052, which, when it becomes effective on December 5, 2011, will transfer the definition of “institutional accounts” currently found in NASD Rule 3110(c)(4) to FINRA Rule 4512(c). See Securities Exchange Act Release No. 63784 (January 27, 2011), 76 FR 5850 (February 2, 2011) (Approving SR-FINRA-2010-052); Regulatory Notice 11-19 (April 2011) (SEC Approves Consolidated FINRA Rules Governing Books and Records). The text of proposed Rule 5123 will be amended to reflect this change after SR-FINRA-2010-052 becomes effective.

- banks, as defined in Section 3(a)(2) of the Securities Act; and
- employees and affiliates of the issuer.

In addition, the Rule would exempt the following types of offerings:

- 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 of exempt 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 (see NASD Notice to Members 02-32 (June 2002));
- offerings of “variable contracts” as defined in Rule 2320(b)(2);
- offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(b)(8)(E);
- offerings of non-convertible debt or preferred securities by issuers that meet the eligibility criteria for incorporation by reference in Forms S-3 and F-3;³
- 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;
- offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(11) of the Commodity Exchange Act; and
- offerings filed with FINRA under Rules 2310, 5110, 5121 and 5122.

These proposed exemptions are very similar to the exemptions in existing Rule 5122 (Member Private Offerings), upon which proposed Rule 5123 is based. The only

³ FINRA notes that the Commission recently adopted amendments to remove any references to credit ratings from its rules and forms promulgated under the Securities Act of 1933 and the Securities Exchange Act of 1934. See, e.g., Security Ratings, Securities Act Release No. 9245 (July 27, 2011), 76 FR 46603 (August 3, 2011). FINRA is proposing to use the references described therein in the proposed rule change.

differences in the exemptions are that the current proposed Rule would not exempt (1) offerings in which a member acts in a wholesaling capacity and (2) offerings of certain credit derivatives, both of which are exempted from Rule 5122.⁴ Wholesaling is typically engaged in by broker-dealers affiliated with the issuer, and for reasons described in Section 5 below, FINRA does not intend to incorporate that exemption into proposed Rule 5123. The exemption for offerings of equity and credit derivatives was intended to avoid attributing certain derivative products on unaffiliated issuers as a “member private offering.” However, since proposed Rule 5123 would apply to all offerings in which a member participates, that distinction is not relevant to Rule 5123.

Proposed Rule 5123 contains provisions identical to those in current Rule 5122 regarding confidential treatment and application for exemption. Pursuant to proposed paragraph 5123(d), FINRA would accord confidential treatment to all documents and information filed pursuant to the Rule, and would use such documents and information solely for the purpose of determining compliance with FINRA rules or other applicable regulatory purposes. Proposed paragraph 5123(e) would provide members a method for application for an exemption from the provisions of the Rule for good cause pursuant to the Rule 9600 Series.

As noted in Item 2 of this filing, FINRA will announce the implementation date of the proposed rule change no later than 90 days following Commission approval. The implementation date will be no more than 180 days following Commission approval

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of

⁴ The proposed rule change would also, as noted supra at note 3, replace references to credit ratings with alternative language.

Section 15A(b)(6) of the Act,⁵ 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. The proposed rule change will provide investors in private placements with detailed information about the intended use of offering proceeds, the offering expenses and offering compensation. In addition, the proposed rule change will provide FINRA with more timely and detailed information about the private placement activities of member firms. As a result, FINRA believes that ensuring that investors have information about private placements will provide important investor protections in connection with private placements without unduly restricting capital formation through the private placement offering process. In addition, FINRA believes that the proposed rule change will assist its efforts to identify problematic terms and conditions in private placements, thereby helping to detect and prevent fraud in connection with private placements.

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. The proposed rule change requires that members and associated persons provide relevant disclosures to each investor prior to the sale of applicable private placements, and file disclosure documents with FINRA no later than 15 calendar days after the date of the first sale (or, in the case of material amendments, the date provided to an investor or prospective investor). As noted above, the proposed rule change will not unduly restrict capital formation through the private placement offering process. The relatively modest

⁵ 15 U.S.C. 78o-3(b)(6).

“burden” of the proposed rule change is both necessary and appropriate in helping 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.

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

In January 2011, FINRA published Regulatory Notice 11-04 requesting comment on proposed amendments to expand Rule 5122 (the “11-04 Proposal”). A copy of the Notice is attached as Exhibit 2a. The comment period expired on March 14, 2011. FINRA received 35 comments in response to the Notice. A list of the commenters in response to the Notice is attached as Exhibit 2b, and copies of the comment letters received in response to the Notice are attached as Exhibit 2c.⁶ A summary of the comments and FINRA’s response is provided below.

The 11-04 Proposal

The 11-04 Proposal would have extended virtually all of the existing requirements of Rule 5122, i.e., those requiring disclosure, filing and limitations on the use of offering proceeds, to all private placements in which a member participates (subject to the listed exemptions). While many commenters expressed support for the 11-04 Proposal,⁷ many, as discussed below, were critical of various provisions. Most criticisms concerned proposed requirements regarding the use of offering proceeds and filing. FINRA has considered the comments received in response to the 11-04 Proposal. The proposed rule change balances the goals of ensuring investors and FINRA receive key information

⁶ See Exhibit 2b for a list of abbreviations assigned to commenters.

⁷ See, e.g., letters from Cornell, FSI, Intellivest Securities, Mick & Associates, NIBA and WSI.

about private placements while maintaining the flexibility and expediency offered by private placements. Based on these considerations, the current proposed rule change differs in several key respects from the 11-04 Proposal.

Comments Regarding Use of Offering Proceeds

The issue generating the most comment was the proposed use of proceeds limitation (i.e., the proposed requirement that 85 percent of the proceeds raised be used for the business purposes described in the disclosure document). Many commenters expressed concerns about the ability of members to monitor an issuer's use of proceeds and the Rule's potential for additional liability if the use of proceeds deviates from that provided in the required disclosure document.⁸ Some raised concerns that, as written, the proposed Rule would impose burdens on or attempt to regulate non-FINRA members.⁹

Some commenters asserted the proposed 85 percent limitation was an arbitrary "one size fits all" approach and could be a barrier to capital formation, especially for smaller offerings or other specific types of offerings.¹⁰ Commenters suggested that the fixed costs of smaller offerings, or higher cost of specific types of offerings, could make this limitation unworkable. A few commenters feared that constraints on the allowable expenses for such offerings could force issuers to explore alternative means of raising capital without the assistance of member firms, including the use finders and unregistered

⁸ See letters from 3PM, ABA, AOG, George, IPA, NYC Bar, NY State Bar, NIBA, Secore & Waller, SIFMA and Sullivan & Cromwell.

⁹ See letters from ABA, NYC Bar, Patrick, Saxony, SIFMA and Sullivan & Cromwell.

¹⁰ See letters from ABA, AOG, BFS, FSI, George, IMS, IPA, NY State Bar, Patrick, Rothwell Consulting, Saxony, Schulten Ward, Secore & Waller, WSI and Weinstein Smith.

persons.¹¹ In addition, commenters raised interpretive questions regarding whether certain expenses – including, among other things, costs relating to due diligence, legal, travel, blue sky, stock grants, warrants, tail fees, rights of first refusal, conference expenses, trail fees, management fees and appraisals and valuations – would be required to be treated as “offering expenses” or would constitute proceeds used for business purposes.¹²

Some commenters recommended that FINRA simply require greater disclosures about the various uses of proceeds, offering expenses, and compensation as an alternative to adopting a use of offering proceeds limitation.¹³ Based in large part on these comments, as discussed above, FINRA has amended the proposal such that it no longer includes the substantive requirement that at least 85 percent of offering proceeds must be used for the disclosed business purposes and has instead chosen to reorient the Rule towards disclosure.

While FINRA continues to believe that the manner in which offering proceeds are used is critically important in a private placement – and that offerings in which a large percentage of offering proceeds are for other than business purposes raise regulatory concerns – FINRA believes that these concerns can be addressed through the obligations of broker-dealers, under the suitability and anti-fraud provisions of the securities laws

¹¹ See letters from ABA, Krieger & Prager and REISA.

¹² See letters from ABA, IMS, Locke Lord, Mick & Associates, Network 1, Patrick, REISA, Saxony, Secore & Waller, SIFMA, Sullivan & Cromwell and Weinstein Smith.

¹³ See letters from FSI, IPA, NIBA, REISA and WSI.

and FINRA rules, to conduct a reasonable inquiry of an issuer.¹⁴ FINRA appreciates the importance of raising capital in the private placement market for certain issuers and recognizes commenters' concerns that an across-the-board application of the 85 percent requirement may impose unnecessary burdens on some offerings, especially smaller private placements. FINRA's expectation is that the reasonable inquiry obligations of broker-dealers will encourage reasonable limits on the use of offering proceeds for purposes other than generating a return on investment. If the rigorous application of the reasonable inquiry obligations outlined in Regulatory Notice 10-22 does not achieve this result, FINRA will reconsider the imposition of numerical limitations. In addition, eliminating the 85 percent requirement will simplify the administration of the Rule by removing the need for members to determine whether various expenses would have been classified as "offering expenses," "compensation," or "business purposes" under the Rule. In the public offering context, FINRA's Corporate Financing Department staff's review process in connection with issuing a "no-objections" opinion ensures consistent and accurate treatment of various expenses. Since only a "notice" filing is required in proposed Rule 5123, the lack of staff review and comment could raise interpretive questions regarding the application of the 85 percent requirement if the provision remained in the Rule. Lastly, eliminating the 85 percent requirement would eliminate any implication, as indicated by some comments, that the 11-04 Proposal would create an

¹⁴

See Regulatory Notice 10-22 (April 2010) (Regulation D Offerings).

independent, continuing obligation for members to monitor an unaffiliated issuer's use of proceeds after the closing of an offering.¹⁵

Comments Regarding Filing Requirements

The 11-04 Proposal would have required a member to file information with FINRA by the time an offering document is provided to any investor. While the 11-04 Proposal states that offerings would not be held in abeyance pending FINRA staff review and that filings would not be "approved" nor would the staff issue "no-objections" opinions, commenters raised concerns about potential slowdowns of offerings due to the filing requirement. Several commenters believed that the 11-04 Proposal's filing requirement could delay the offering process as firms would be reluctant to proceed with an offering without assurances or clearances from FINRA.¹⁶ Commenters also raised technical concerns about the proposed filing process, including concerns regarding who

¹⁵ Members have an obligation to conduct a reasonable inquiry regarding the use of proceeds prior to making a recommendation in that security. See, e.g., Regulatory Notice 10-22 (regarding private placements). Such a recommendation would not comply with the requirements of FINRA's suitability rule if the description of the use of proceeds in the disclosure document is inconsistent with the information obtained in the course of this inquiry. See NASD Rule 2310 (Recommendations to Customers (Suitability)). FINRA notes that the SEC has approved new FINRA Rule 2111 (Suitability). See Regulatory Notice 11-02 (January 2011) (SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligations). See also Securities Exchange Act Release No. 63325 (November 17, 2010), 75 FR 71479 (November 23, 2010) (File No. SR-FINRA-2010-039; Order Granting Accelerated Approval, As Modified by Amendment, to Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook); Securities Exchange Act Release No. 64260 (April 8, 2011), 76 FR 20759 (April 13, 2011) (File No. SR-FINRA-2011-016; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Delay the Implementation Date of FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability)).

¹⁶ See letters from ABA, Achates, IMS, Intellivest, IPA, George, LeGaye, Network 1, NIBA, NYC Bar, NY State Bar, Patrick, REISA, Saxony, Secore & Waller and Sullivan & Cromwell.

must file (e.g., each selling dealer in a private placement), how members of a selling group would know if an offering memorandum had been previously filed, and who bears the responsibility to file amendments.¹⁷ A few commenters, including the NYC Bar, suggested that the application of the filing requirement would result in offerings structured to avoid application of the Rule, either by limiting the offering to exempted investors or moving the transaction offshore.

In response to these comments, FINRA now proposes to require that a member file “no later than 15 calendar days after the date of first sale.” This timing requirement is the same as the filing requirement for Form D; synchronizing these timing requirements may allow some filers to utilize operational efficiencies. Moreover, by requiring a “notice” filing, FINRA will remove any implication that the FINRA staff will provide comments on a filing; that such filing with FINRA could be a precondition to commencing an offering; or that members should expect to receive any FINRA staff input before proceeding with an offering. The proposed filing requirement would nevertheless provide FINRA staff with timely access to information about the private placement business of FINRA members.

The proposal would require that each member that participates in a private placement make the requisite filing. FINRA had considered requiring only one member to file, but determined that such a requirement would limit its ability to gain timely access to information about the private placement business of FINRA members that might not file. Moreover, as the comment letters indicate, requiring only one member to file would complicate the ability of the other members to participate, since they would have to

¹⁷ See letters from Achates, FSI and Moloney.

determine whether another member had filed and whether the filing complies with FINRA's requirements. If one member engaged in the private placement under different compensation terms than another member, then it could further complicate such a single-filer regime. Therefore, it is more practical, and more helpful to FINRA's need for timely access to information about the private placement business of members, to require every member that participates in a particular private placement to make the notice filing.

Other Comments

Comments regarding disclosure ranged from support¹⁸ to requests for clarification or guidance regarding what would constitute adequate disclosure¹⁹ to claims that disclosure would be duplicative of that provided to the SEC pursuant to Regulation D.²⁰ Some requested clarification of specific types of disclosure (e.g. sponsor fees,²¹ non-variable third party costs²² or the scope of offering expenses²³).

Several commenters suggested narrowing the scope of the Rule through additional exemptions, including adding exemptions for offers and sales to: all accredited investors;²⁴ small groups of accredited investors;²⁵ or alternatively a de minimis

¹⁸ See letter from WSI.

¹⁹ See letter from LeGaye.

²⁰ See letter from NY State Bar.

²¹ See letter from AOG.

²² See letter from Weinstein Smith.

²³ See letters from IMS and Weinstein Smith.

²⁴ See letters from NYC Bar, SIFMA, Sullivan & Cromwell and Weinstein Smith.

²⁵ See letter from LeGaye.

exemption for sales to accredited investors;²⁶ other registered broker-dealers in connection with the establishment of a joint back office arrangement;²⁷ issuers that are reporting companies under the federal securities laws;²⁸ knowledgeable employees or officers of the issuing company;²⁹ or when there is a change in ownership.³⁰ Others argued that exemptions for the following types of securities should be added: insurance contracts;³¹ mergers and acquisitions structured as a stock sale either for cash or for acquirer stock;³² secondary sales of securities;³³ and privately offered commodity pools and investment funds.³⁴

FINRA believes the exemptions in the proposed rule change are appropriately tailored and inclusive, and as noted above, are very similar to those in existing Rule 5122. Based upon its experience with Rule 5122, FINRA does not believe it should expand the list of exemptions. Further, FINRA notes that the proposed Rule would provide a method by which a member may apply for an exemption from the provisions of the Rule for good cause pursuant to the Rule 9600 Series.

²⁶ See letters from ABA, IMS, NYC Bar, Rothwell Consulting, SIFMA, St. Charles and Sullivan & Cromwell.

²⁷ See letter from ABA.

²⁸ See letter from SIFMA.

²⁹ See letters from ABA, SIFMA and St. Charles.

³⁰ See letter from IMS.

³¹ See letter from Sutherland.

³² See letter from NYC Bar

³³ See letter from Sullivan & Cromwell.

³⁴ See letter from MFA.

Some commenters supported FINRA's proposal not to incorporate the wholesaling exemption into the Rule,³⁵ while others questioned the elimination of this exemption, especially as the 11-04 Proposal would have eliminated the exemption for member private offerings as well as private placements more generally.³⁶ The basis for this exemption in Rule 5122 was that distribution of the private placement by independent retail broker-dealers would obviate the need for the rule, which applies to private placements in which the selling member or its control entity is the issuer. However, given that the current proposed rule change reaches all private placements, the reliance upon the efforts of an "independent" broker-dealer is no longer relevant. Accordingly, the wholesaling exemption is not provided in proposed Rule 5123.

Commenters also requested that the Rule (or supplementary material) state that the exemption provisions may be combined without triggering the requirements of the Rule.³⁷ FINRA notes that the exemption provisions may be combined. These exemptions are derived from those in Rule 5122. In announcing the approval of Rule 5122, FINRA stated as follows:

Types of exemptions may be combined without triggering the requirements of the rule. For example, if an MPO is offered to both qualified purchasers and employees or affiliates of the issuer or its control entities, as long as these purchasers qualify for exemptions under the rule, the MPO would be exempt from the rule's requirements.³⁸

³⁵ See letters from Cornell, NIBA and SIFMA.

³⁶ See letters from 3PM, LeGaye, SIFMA and WSI.

³⁷ See letters from ABA, NYC Bar, Rothwell Consulting and SIFMA.

³⁸ See Regulatory Notice 09-27 (May 2009) (Member Private Offerings).

FINRA would make a similar statement in connection with a Regulatory Notice regarding this Rule.

One commenter raised a concern that, as proposed, the Rule would not afford confidential treatment to any comment or similar letters by FINRA, and thus they could be discovered by a litigant through appropriate legal action.³⁹ FINRA believes that proposed paragraph 5123(d) addresses this issue and would afford confidential treatment to all such documents.

As a result of the differences between the 11-04 Proposal (and Rule 5122) and the current proposed Rule, as described above, FINRA is proposing that the rule regarding private placements be a new rule separate from Rule 5122.⁴⁰

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.⁴¹

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.

³⁹ See letter from ABA.

⁴⁰ FINRA believes that the provisions of existing Rule 5122 are appropriate for the types of private offerings covered by that rule, i.e., the offering of securities issued by a member or its control affiliate. In addition, FINRA is not aware of any concerns regarding the timing of Rule 5122's filing requirement.

⁴¹ 15 U.S.C. 78s(b)(2).

9. Exhibits

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

Exhibit 2a. Regulatory Notice 11-04 (January 2011) (Private Placements of Securities: FINRA Requests Comment on Proposed Amendments to FINRA Rule 5122 to Address Member Firm Participation in Private Placements).

Exhibit 2b. List of comments received in response to Regulatory Notice 11-04.

Exhibit 2c. Copies of comments received in response to Regulatory Notice 11-04.

Exhibit 5. Text of the proposed rule change (FINRA Rule 5123).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2011-057)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Adopt New FINRA Rule 5123 (Private Placements of Securities)

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”) 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 FINRA Rule 5123, which as described further below, would require that members and associated persons that offer or sell applicable private placements (as described in the Rule), or participate in the preparation of private placement memoranda (“PPM”), term sheets or other disclosure documents in connection with such private placements, provide relevant disclosures to each investor prior to sale describing the anticipated use of offering proceeds, and the amount and type of offering expenses and offering compensation. FINRA Rule 5123 also would require that the PPM, term sheet or other disclosure document, and any exhibits thereto, be filed with

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

FINRA no later than 15 calendar days after the date of the first sale, and any material amendments to such document, or any amendments to the disclosures mandated by the Rule, be filed no later than 15 calendar days after the date such document is provided to any investor or prospective investor, as discussed further below.

The text of the proposed rule change is available on FINRA's website 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

FINRA is proposing to adopt new Rule 5123 (Private Placements of Securities) to ensure that investors in private placements are provided detailed information about the intended use of offering proceeds, the offering expenses and offering compensation. In addition, new Rule 5123 would provide FINRA, through a member "notice" filing requirement, with more timely and detailed information about the private placement activities of member firms.

Rule 5123(a) would prohibit a member or person associated with a member from offering or selling any security conducted in reliance on an available exemption from

registration under the Securities Act (“private placement”), or participating in the preparation of a PPM, term sheet or other disclosure document for such private placement, unless the member or associated person provides a PPM or term sheet to each investor prior to sale that describes the anticipated use of offering proceeds, the amount and type of offering expenses, and the amount and type of compensation provided or to be provided to sponsors, finders, consultants and members and their associated persons in connection with the offering, or, in private placements without a PPM or term sheet, preparing a document that contains these disclosures and providing it to each investor prior to sale.

Proposed Rule 5123(b) would require “notice” filings of members’ private placement activities. Specifically, the proposed Rule would require participating members to file the PPM, term sheet or other disclosure document (including exhibits) with FINRA no later than 15 calendar days after the date of first sale, and to file any material amendments to such document, or any amendments to the disclosures mandated by the Rule, with FINRA no later than 15 calendar days after the date such document is provided to any investor or prospective investor.

Proposed Rule 5123(c) would exempt from the requirements of the Rule several types of private placements. Exemptions include offerings sold only to any one or more of the following purchasers:

- institutional accounts, as defined in NASD Rule 3110(c)(4);³
- 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;
- banks, as defined in Section 3(a)(2) of the Securities Act; and
- employees and affiliates of the issuer.

In addition, the Rule would exempt the following types of offerings:

- 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 of exempt 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 (see NASD Notice to Members 02-32 (June 2002));
- offerings of “variable contracts” as defined in Rule 2320(b)(2);
- offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(b)(8)(E);

³

The SEC approved SR-FINRA-2010-052, which, when it becomes effective on December 5, 2011, will transfer the definition of “institutional accounts” currently found in NASD Rule 3110(c)(4) to FINRA Rule 4512(c). See Securities Exchange Act Release No. 63784 (January 27, 2011), 76 FR 5850 (February 2, 2011) (Approving SR-FINRA-2010-052); Regulatory Notice 11-19 (April 2011) (SEC Approves Consolidated FINRA Rules Governing Books and Records). The text of proposed Rule 5123 will be amended to reflect this change after SR-FINRA-2010-052 becomes effective.

- offerings of non-convertible debt or preferred securities by issuers that meet the eligibility criteria for incorporation by reference in Forms S-3 and F-3;⁴
- 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;
- offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(11) of the Commodity Exchange Act; and
- offerings filed with FINRA under Rules 2310, 5110, 5121 and 5122.

These proposed exemptions are very similar to the exemptions in existing Rule 5122 (Member Private Offerings), upon which proposed Rule 5123 is based. The only differences in the exemptions are that the current proposed Rule would not exempt (1) offerings in which a member acts in a wholesaling capacity and (2) offerings of certain credit derivatives, both of which are exempted from Rule 5122.⁵ Wholesaling is typically engaged in by broker-dealers affiliated with the issuer, and for reasons described in Section 5 below, FINRA does not intend to incorporate that exemption into proposed Rule 5123. The exemption for offerings of equity and credit derivatives was intended to avoid attributing certain derivative products on unaffiliated issuers as a “member private offering.” However, since proposed Rule 5123 would apply to all offerings in which a member participates, that distinction is not relevant to Rule 5123.

⁴ FINRA notes that the Commission recently adopted amendments to remove any references to credit ratings from its rules and forms promulgated under the Securities Act of 1933 and the Securities Exchange Act of 1934. See, e.g., Security Ratings, Securities Act Release No. 9245 (July 27, 2011), 76 FR 46603 (August 3, 2011). FINRA is proposing to use the references described therein in the proposed rule change.

⁵ The proposed rule change also would, as noted supra at note 4, replace references to credit ratings with alternative language.

Proposed Rule 5123 contains provisions identical to those in current Rule 5122 regarding confidential treatment and application for exemption. Pursuant to proposed paragraph 5123(d), FINRA would accord confidential treatment to all documents and information filed pursuant to the Rule, and would use such documents and information solely for the purpose of determining compliance with FINRA rules or other applicable regulatory purposes. Proposed paragraph 5123(e) would provide members a method for application for an exemption from the provisions of the Rule for good cause pursuant to the Rule 9600 Series.

FINRA will announce the implementation date of the proposed rule change no later than 90 days following Commission approval. The implementation date will be no more than 180 days following Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁶ 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. The proposed rule change will provide investors in private placements with detailed information about the intended use of offering proceeds, the offering expenses and offering compensation. In addition, the proposed rule change will provide FINRA with more timely and detailed information about the private placement activities of member firms. As a result, FINRA believes that ensuring that investors have information about private placements will provide important investor protections in connection with

⁶ 15 U.S.C. 78o-3(b)(6).

private placements without unduly restricting capital formation through the private placement offering process. In addition, FINRA believes that the proposed rule change will assist its efforts to identify problematic terms and conditions in private placements, thereby helping to detect and prevent fraud in connection with private placements.

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. The proposed rule change requires that members and associated persons provide relevant disclosures to each investor prior to the sale of applicable private placements, and file disclosure documents with FINRA no later than 15 calendar days after the date of the first sale (or, in the case of material amendments, the date provided to an investor or prospective investor). As noted above, the proposed rule change will not unduly restrict capital formation through the private placement offering process. The relatively modest "burden" of the proposed rule change is both necessary and appropriate in helping 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.

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

In January 2011, FINRA published Regulatory Notice 11-04 requesting comment on proposed amendments to expand Rule 5122 (the "11-04 Proposal"). A copy of the Notice is attached as Exhibit 2a. The comment period expired on March 14, 2011. FINRA received 35 comments in response to the Notice. A list of the commenters in response to the Notice is attached as Exhibit 2b, and copies of the comment letters

received in response to the Notice are attached as Exhibit 2c.⁷ A summary of the comments and FINRA's response is provided below.

The 11-04 Proposal

The 11-04 Proposal would have extended virtually all of the existing requirements of Rule 5122, i.e., those requiring disclosure, filing and limitations on the use of offering proceeds, to all private placements in which a member participates (subject to the listed exemptions). While many commenters expressed support for the 11-04 Proposal,⁸ many, as discussed below, were critical of various provisions. Most criticisms concerned proposed requirements regarding the use of offering proceeds and filing. FINRA has considered the comments received in response to the 11-04 Proposal. The proposed rule change balances the goals of ensuring investors and FINRA receive key information about private placements while maintaining the flexibility and expediency offered by private placements. Based on these considerations, the current proposed rule change differs in several key respects from the 11-04 Proposal.

Comments Regarding Use of Offering Proceeds

The issue generating the most comment was the proposed use of proceeds limitation (i.e., the proposed requirement that 85 percent of the proceeds raised be used for the business purposes described in the disclosure document). Many commenters expressed concerns about the ability of members to monitor an issuer's use of proceeds and the Rule's potential for additional liability if the use of proceeds deviates from that

⁷ See Exhibit 2b for a list of abbreviations assigned to commenters.

⁸ See, e.g., letters from Cornell, FSI, Intellivest Securities, Mick & Associates, NIBA and WSI.

provided in the required disclosure document.⁹ Some raised concerns that, as written, the proposed Rule would impose burdens on or attempt to regulate non-FINRA members.¹⁰

Some commenters asserted the proposed 85 percent limitation was an arbitrary “one size fits all” approach and could be a barrier to capital formation, especially for smaller offerings or other specific types of offerings.¹¹ Commenters suggested that the fixed costs of smaller offerings, or higher cost of specific types of offerings, could make this limitation unworkable. A few commenters feared that constraints on the allowable expenses for such offerings could force issuers to explore alternative means of raising capital without the assistance of member firms, including the use finders and unregistered persons.¹² In addition, commenters raised interpretive questions regarding whether certain expenses -- including, among other things, costs relating to due diligence, legal, travel, blue sky, stock grants, warrants, tail fees, rights of first refusal, conference expenses, trail fees, management fees and appraisals and valuations -- would be required to be treated as “offering expenses” or would constitute proceeds used for business purposes.¹³

⁹ See letters from 3PM, ABA, AOG, George, IPA, NYC Bar, NY State Bar, NIBA, Secore & Waller, SIFMA and Sullivan & Cromwell.

¹⁰ See letters from ABA, NYC Bar, Patrick, Saxony, SIFMA and Sullivan & Cromwell.

¹¹ See letters from ABA, AOG, BFS, FSI, George, IMS, IPA, NY State Bar, Patrick, Rothwell Consulting, Saxony, Schulten Ward, Secore & Waller, WSI and Weinstein Smith.

¹² See letters from ABA, Krieger & Prager and REISA.

¹³ See letters from ABA, IMS, Locke Lord, Mick & Associates, Network 1, Patrick, REISA, Saxony, Secore & Waller, SIFMA, Sullivan & Cromwell and Weinstein Smith.

Some commenters recommended that FINRA simply require greater disclosures about the various uses of proceeds, offering expenses, and compensation as an alternative to adopting a use of offering proceeds limitation.¹⁴ Based in large part on these comments, as discussed above, FINRA has amended the proposal such that it no longer includes the substantive requirement that at least 85 percent of offering proceeds must be used for the disclosed business purposes and has instead chosen to reorient the Rule towards disclosure.

While FINRA continues to believe that the manner in which offering proceeds are used is critically important in a private placement – and that offerings in which a large percentage of offering proceeds are for other than business purposes raise regulatory concerns – FINRA believes that these concerns can be addressed through the obligations of broker-dealers, under the suitability and anti-fraud provisions of the securities laws and FINRA rules, to conduct a reasonable inquiry of an issuer.¹⁵ FINRA appreciates the importance of raising capital in the private placement market for certain issuers and recognizes commenters’ concerns that an across-the-board application of the 85 percent requirement may impose unnecessary burdens on some offerings, especially smaller private placements. FINRA’s expectation is that the reasonable inquiry obligations of broker-dealers will encourage reasonable limits on the use of offering proceeds for purposes other than generating a return on investment. If the rigorous application of the reasonable inquiry obligations outlined in Regulatory Notice 10-22 does not achieve this result, FINRA will reconsider the imposition of numerical limitations. In addition,

¹⁴ See letters from FSI, IPA, NIBA, REISA and WSI.

¹⁵ See Regulatory Notice 10-22 (April 2010) (Regulation D Offerings).

eliminating the 85 percent requirement will simplify the administration of the Rule by removing the need for members to determine whether various expenses would have been classified as “offering expenses,” “compensation,” or “business purposes” under the Rule. In the public offering context, FINRA’s Corporate Financing Department staff’s review process in connection with issuing a “no-objections” opinion ensures consistent and accurate treatment of various expenses. Since only a “notice” filing is required in proposed Rule 5123, the lack of staff review and comment could raise interpretive questions regarding the application of the 85 percent requirement if the provision remained in the Rule. Lastly, eliminating the 85 percent requirement would eliminate any implication, as indicated by some comments, that the 11-04 Proposal would create an independent, continuing obligation for members to monitor an unaffiliated issuer’s use of proceeds after the closing of an offering.¹⁶

¹⁶ Members have an obligation to conduct a reasonable inquiry regarding the use of proceeds prior to making a recommendation in that security. See, e.g., Regulatory Notice 10-22 (regarding private placements). Such a recommendation would not comply with the requirements of FINRA’s suitability rule if the description of the use of proceeds in the disclosure document is inconsistent with the information obtained in the course of this inquiry. See NASD Rule 2310 (Recommendations to Customers (Suitability)). FINRA notes that the SEC has approved new FINRA Rule 2111 (Suitability). See Regulatory Notice 11-02 (January 2011) (SEC Approves Consolidated FINRA Rules Governing Know-Your-Customer and Suitability Obligations). See also Securities Exchange Act Release No. 63325 (November 17, 2010), 75 FR 71479 (November 23, 2010) (File No. SR-FINRA-2010-039; Order Granting Accelerated Approval, As Modified by Amendment, to Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook); Securities Exchange Act Release No. 64260 (April 8, 2011), 76 FR 20759 (April 13, 2011) (File No. SR-FINRA-2011-016; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Delay the Implementation Date of FINRA Rule 2090 (Know Your Customer) and FINRA Rule 2111 (Suitability)).

Comments Regarding Filing Requirements

The 11-04 Proposal would have required a member to file information with FINRA by the time an offering document is provided to any investor. While the 11-04 Proposal states that offerings would not be held in abeyance pending FINRA staff review and that filings would not be “approved” nor would the staff issue “no-objections” opinions, commenters raised concerns about potential slowdowns of offerings due to the filing requirement. Several commenters believed that the 11-04 Proposal’s filing requirement could delay the offering process as firms would be reluctant to proceed with an offering without assurances or clearances from FINRA.¹⁷ Commenters also raised technical concerns about the proposed filing process, including concerns regarding who must file (e.g., each selling dealer in a private placement), how members of a selling group would know if an offering memorandum had been previously filed, and who bears the responsibility to file amendments.¹⁸ A few commenters, including the NYC Bar, suggested that the application of the filing requirement would result in offerings structured to avoid application of the Rule, either by limiting the offering to exempted investors or moving the transaction offshore.

In response to these comments, FINRA now proposes to require that a member file “no later than 15 calendar days after the date of first sale.” This timing requirement is the same as the filing requirement for Form D; synchronizing these timing requirements may allow some filers to utilize operational efficiencies. Moreover, by

¹⁷ See letters from ABA, Achates, IMS, Intellivest, IPA, George, LeGaye, Network 1, NIBA, NYC Bar, NY State Bar, Patrick, REISA, Saxony, Secore & Waller and Sullivan & Cromwell.

¹⁸ See letters from Achates, FSI and Moloney.

requiring a “notice” filing, FINRA will remove any implication that the FINRA staff will provide comments on a filing; that such filing with FINRA could be a precondition to commencing an offering; or that members should expect to receive any FINRA staff input before proceeding with an offering. The proposed filing requirement would nevertheless provide FINRA staff with timely access to information about the private placement business of FINRA members.

The proposal would require that each member that participates in a private placement make the requisite filing. FINRA had considered requiring only one member to file, but determined that such a requirement would limit its ability to gain timely access to information about the private placement business of FINRA members that might not file. Moreover, as the comment letters indicate, requiring only one member to file would complicate the ability of the other members to participate, since they would have to determine whether another member had filed and whether the filing complies with FINRA’s requirements. If one member engaged in the private placement under different compensation terms than another member, then it could further complicate such a single-filer regime. Therefore, it is more practical, and more helpful to FINRA’s need for timely access to information about the private placement business of members, to require every member that participates in a particular private placement to make the notice filing.

Other Comments

Comments regarding disclosure ranged from support¹⁹ to requests for clarification or guidance regarding what would constitute adequate disclosure²⁰ to claims that

¹⁹ See letter from WSI.

²⁰ See letter from LeGaye.

disclosure would be duplicative of that provided to the SEC pursuant to Regulation D.²¹

Some requested clarification of specific types of disclosure (e.g. sponsor fees,²² non-variable third party costs²³ or the scope of offering expenses²⁴).

Several commenters suggested narrowing the scope of the Rule through additional exemptions, including adding exemptions for offers and sales to: all accredited investors;²⁵ small groups of accredited investors;²⁶ or alternatively a de minimis exemption for sales to accredited investors;²⁷ other registered broker-dealers in connection with the establishment of a joint back office arrangement;²⁸ issuers that are reporting companies under the federal securities laws;²⁹ knowledgeable employees or officers of the issuing company;³⁰ or when there is a change in ownership.³¹ Others argued that exemptions for the following types of securities should be added: insurance

²¹ See letter from NY State Bar.

²² See letter from AOG.

²³ See letter from Weinstein Smith.

²⁴ See letters from IMS and Weinstein Smith.

²⁵ See letters from NYC Bar, SIFMA, Sullivan & Cromwell and Weinstein Smith.

²⁶ See letter from LeGaye.

²⁷ See letters from ABA, IMS, NYC Bar, Rothwell Consulting, SIFMA, St. Charles and Sullivan & Cromwell.

²⁸ See letter from ABA.

²⁹ See letter from SIFMA.

³⁰ See letters from ABA, SIFMA and St. Charles.

³¹ See letter from IMS.

contracts;³² mergers and acquisitions structured as a stock sale either for cash or for acquirer stock;³³ secondary sales of securities;³⁴ and privately offered commodity pools and investment funds.³⁵

FINRA believes the exemptions in the proposed rule change are appropriately tailored and inclusive, and as noted above, are very similar to those in existing Rule 5122. Based upon its experience with Rule 5122, FINRA does not believe it should expand the list of exemptions. Further, FINRA notes that the proposed Rule would provide a method by which a member may apply for an exemption from the provisions of the Rule for good cause pursuant to the Rule 9600 Series.

Some commenters supported FINRA's proposal not to incorporate the wholesaling exemption into the Rule,³⁶ while others questioned the elimination of this exemption, especially as the 11-04 Proposal would have eliminated the exemption for member private offerings as well as private placements more generally.³⁷ The basis for this exemption in Rule 5122 was that distribution of the private placement by independent retail broker-dealers would obviate the need for the rule, which applies to private placements in which the selling member or its control entity is the issuer. However, given that the current proposed rule change reaches all private placements, the

³² See letter from Sutherland.

³³ See letter from NYC Bar

³⁴ See letter from Sullivan & Cromwell.

³⁵ See letter from MFA.

³⁶ See letters from Cornell, NIBA and SIFMA.

³⁷ See letters from 3PM, LeGaye, SIFMA and WSI.

reliance upon the efforts of an “independent” broker-dealer is no longer relevant.

Accordingly, the wholesaling exemption is not provided in proposed Rule 5123.

Commenters also requested that the Rule (or supplementary material) state that the exemption provisions may be combined without triggering the requirements of the Rule.³⁸ FINRA notes that the exemption provisions may be combined. These exemptions are derived from those in Rule 5122. In announcing the approval of Rule 5122, FINRA stated as follows:

Types of exemptions may be combined without triggering the requirements of the rule. For example, if an MPO is offered to both qualified purchasers and employees or affiliates of the issuer or its control entities, as long as these purchasers qualify for exemptions under the rule, the MPO would be exempt from the rule’s requirements.³⁹

FINRA would make a similar statement in connection with a Regulatory Notice regarding this Rule.

One commenter raised a concern that, as proposed, the Rule would not afford confidential treatment to any comment or similar letters by FINRA, and thus they could be discovered by a litigant through appropriate legal action.⁴⁰ FINRA believes that proposed paragraph 5123(d) addresses this issue and would afford confidential treatment to all such documents.

As a result of the differences between the 11-04 Proposal (and Rule 5122) and the current proposed Rule, as described above, FINRA is proposing that the rule regarding

³⁸ See letters from ABA, NYC Bar, Rothwell Consulting and SIFMA.

³⁹ See Regulatory Notice 09-27 (May 2009) (Member Private Offerings).

⁴⁰ See letter from ABA.

private placements be a new rule separate from Rule 5122.⁴¹

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-2011-057 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-2011-057. 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 website (<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

⁴¹ FINRA believes that the provisions of existing Rule 5122 are appropriate for the types of private offerings covered by that rule, *i.e.*, the offering of securities issued by a member or its control affiliate. In addition, FINRA is not aware of any concerns regarding the timing of Rule 5122's filing requirement.

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 website viewing and printing 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-2011-057 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.⁴²

Elizabeth M. Murphy

Secretary

⁴² 17 CFR 200.30-3(a)(12).

EXHIBIT 2b

Alphabetical List of Written Comments

1. Achates Capital Advisors LLC (March 4, 2011) (“Achates”)
2. American Bar Association (March 14, 2011) (“ABA”)
3. AOG Wealth Management (March 14, 2011) (“AOG”)
4. Balanced Financial Securities (February 12, 2011) (“BFS”)
5. Colonnade Securities LLC (March 10, 2011) (“Colonnade”)
6. Cornell University Law School (March 14, 2011) (“Cornell”)
7. Financial Services Institute (March 15, 2011) (“FSI”)
8. Ken George (March 14, 2011) (“George”)
9. Integrated Management Solutions USA LLC (March 14, 2011) (“IMS”)
10. Investment Program Association (March 14, 2011) (“IPA”)
11. Intellivest Securities, Inc. (March 10, 2011) (“Intellivest Securities”)
12. Krieger & Prager, LLP (February 18, 2011) (“Krieger & Prager”)
13. The LeGaye Law Firm P.C. (March 14, 2011) (“LeGaye”)
14. Valerie Lewis (January 19, 2011) (“Lewis”)
15. Locke Lord Bissell & Liddell LLP (March 11, 2011) (“Locke Lord”)
16. Moloney Securities Co., Inc. (March 7, 2011) (“Moloney”)
17. Managed Funds Association (March 14, 2011) (“MFA”)
18. Mick & Associates, P.C., LLO (March 10, 2011) (“Mick & Associates”)
19. National Investment Banking Association (March 14, 2011) (“NIBA”)
20. Network 1 Financial Securities, Inc. (March 10, 2011) (“Network 1”)
21. New York City Bar Association (March 14, 2011) (“NYC Bar”)
22. New York State Bar Association (March 28, 2011) (“NY State Bar”)

23. Patrick Capital Markets, LLC (March 14, 2011) (“Patrick”)
24. Real Estate Investment Securities Association (March 14, 2011) (“REISA”)
25. Rothwell Consulting LLC (March 1, 2011) (“Rothwell Consulting”)
26. Saxony Securities, Inc. (March 14, 2011) (“Saxony”)
27. Schulten, Ward & Turner (February 3, 2011) (“Schulten Ward”)
28. Secore & Waller, L.L.P. (March 14, 2011) (“Secore & Waller”)
29. Securities Industry and Financial Markets Association (March 14, 2011) (“SIFMA”)
30. St. Charles Capital, LLC (March 14, 2011) (“St. Charles”)
31. Sullivan & Cromwell LLP (March 14, 2011) (“Sullivan & Cromwell”)
32. Sutherland Asbill & Brennan LLP (March 14, 2011) (“Sutherland”)
33. Third Party Marketers Association (March 10, 2011) (“3PM”)
34. Walton Securities, Inc. (March 14, 2011) (“WSI”)
35. Weinstein Smith LLP (March 9, 2011) (“Weinstein Smith”)

EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined.

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5120. Offerings of Members' Securities

* * * * *

5123. Private Placements of Securities

(a) Disclosure Requirement

No member or person associated with a member may offer or sell any security in reliance on an available exemption from registration under the Securities Act ("private placement"), or participate in the preparation of a private placement memorandum, term sheet or other disclosure document in connection with such private placement, unless the member or associated person:

(1) provides a private placement memorandum or term sheet to each investor prior to sale that contains disclosures describing the anticipated use of offering proceeds, the amount and type of offering expenses, and the amount and type of compensation provided or to be provided to sponsors, finders, consultants, and members and their associated persons in connection with the offering; or

(2) if such private placement does not have a private placement memorandum or term sheet, prepares a disclosure document that contains the

disclosures required in paragraph (a)(1) and provides such document to each investor prior to sale.

(b) Filing Requirement

The private placement memorandum, term sheet or such other disclosure document, and any exhibits thereto, must be filed with FINRA by the participating member or associated person no later than 15 calendar days after the date of first sale. Any material amendments to the private placement memorandum, term sheet or other disclosure document, or any amendments to the disclosures mandated by this Rule, must be filed with FINRA no later than 15 calendar days after the date such document is provided to any investor or prospective investor.

(c) Exemptions

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

(1) offerings sold solely to any one or more of the following:

(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;

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

(G) employees and affiliates of the issuer.

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

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

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

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

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

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

(8) offerings of non-convertible debt or preferred securities by issuers that meet the eligibility criteria for incorporation by reference in Forms S-3 and F-3;

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

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

(11) offerings filed with FINRA under Rules 2310, 5110, 5121 and 5122.

(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 associated person from the provisions of this Rule for good cause shown.

* * * * *