Business Law Section

AMERICAN BAR ASSOCIATION

321 North Clark Street
Chicago, IL 60654
(312) 988-5588
Fax: (312)988-5578
www.ababusinesslaw.org
businesslaw@abanet.org

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Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: Regulatory Notice 11-04: Private Placements of Securities: Proposed Amendments to FINRA Rule 5122

Dear Ms. Asquith:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the “Section”) of the American Bar Association (the "ABA"), in response to the request for comments by the Financial Industry Regulatory Authority, Inc. ("FINRA") pursuant to FINRA Regulatory Notice 11-04 (the "Notice") as more fully set forth below. This letter was prepared by members of the Subcommittee on FINRA Corporate Financing Rules of the Committee.

The comments expressed in this letter (the "Comment Letter") represent the views of the Committee only and have not been approved by the ABA’s House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

As our letter indicates, we strongly oppose the proposed expansion of the scope of Rule 5122 to cover all private placements in which a member firm participates. We question whether this expansion comports with FINRA’s statutory authority as a registered national securities association under the Securities Exchange Act of 1934 (the "Exchange Act") and we are concerned that the proposed amendments would impose significant procedural burdens on the private offering process that would be inconsistent with Congressional mandates and public policy and impede, in a fundamental way, capital formation. We therefore urge FINRA not to adopt the rule amendments as proposed.

I. Background

FINRA Rule 5122 (the "Rule"), which became effective on June 17, 2009, currently applies only to so-called "member private offerings" – private placements issued by a FINRA member or a control entity of such member in which the FINRA member or an associated person thereof offers and sells the securities being offered. Absent the availability of one of several exemptions, the rule provides for disclosure, filing with FINRA, and limitations on the use of proceeds.

Pursuant to the Notice, FINRA is proposing to amend the Rule to apply to any private placement of securities in which a member firm or associated person thereof "participates," and not just to member private offerings. FINRA also proposes to eliminate the exemption for offerings in which a member acts primarily in a wholesaling capacity.

II. Discussion

(1) The Proposed Amendments to the Rule Would Constitute a Substantial Expansion of FINRA's Regulatory Reach That Would Exceed its Mandate under the Securities Exchange Act of 1934 and Would Be Inconsistent with the Treatment of Private Offerings under the Securities Act of 1933:

FINRA's mandate under the Exchange Act is centered upon, and designed to ensure, that member firms conduct their broker-dealer activities with other market counterparties and public customers in a fair and equitable manner, and in a way that promotes free and open securities markets.[1]

Although the current version of the Rule, which is limited to the raising of capital by member firms for their own benefit or for that of a control entity in which the member (or an associated person thereof) acts as a selling agent, might be within FINRA's statutory mandate, we believe that the proposed amendments would extend substantially beyond that mandate and would contravene other important principles embedded in the securities laws. As proposed, the Rule would impose, absent the availability of an exemption, disclosure, substantive limitations on the use of proceeds, and filing/review requirements with respect to any private offering in which a member firm "participates" (as more fully discussed below). In substance, FINRA's primary impact through the proposed amendments would be to regulate the private offering process and companies that raise capital simply because a member firm is used. The proposed amendments would therefore substantially expand FINRA's historic focus and emphasis, and

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[1] Pursuant to Section 15A(b)(6) of the Exchange Act, a registered national securities association, currently only FINRA, is required to adopt rules that are designed to "prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the association."

establish a "merit"-like regulatory system over non-member issuers that would be akin to many States' securities law provisions. This change would represent a substantial departure from FINRA's historical approach to the regulation of its member firms and their interaction with the financial markets in the context of private offerings. Importantly, imposing these substantive provisions on all private offerings involving member firms would, in our view, be inconsistent with the statutory exemptions for non-public offerings in the Securities Act of 1933 (the "Securities Act") and the rules and regulations adopted pursuant thereto by the Securities and Exchange Commission (the "SEC").

In October 1996, Congress enacted the National Securities Markets Improvement Act of 1996 ("NSMIA") which, among other things, amended Section 18 of the Securities Act to preempt the securities registration requirements of the various States' so-called "Blue Sky" or securities laws with respect to offerings of certain "covered securities." Pursuant to Section 18(a)(2)(A) of the Securities Act, State securities registration requirements are preempted with respect to any offering document in respect of a covered securities offering that is prepared by or on behalf of the issuer. Pursuant to Section 18(a)(2)(C) of the Securities Act, no State law shall, with respect to any offering of covered securities, directly or indirectly, prohibit, limit, or impose conditions, based on the merits of such offering or issuer. Section 18(b)(4)(D) of the Securities Act specifies as a covered securities offering any offering that is conducted pursuant to "Commission rules or regulations issued under section 4(2)," that is, any offering conducted pursuant to Rule 506 of Regulation D under the Securities Act.

Securities offered in private offerings conducted pursuant to Rule 506 of Regulation D, a non-exclusive safe harbor under Section 4(2) of the Securities Act,[2] cannot be offered by way of general solicitation or general advertisement and cannot be sold to more than 35 investors who do not qualify as "accredited investors," as defined in Rule 501(a) of Regulation D. In addition, the issuer must comply with the information requirements of Rule 502(b) of the Securities Act, and any securities sold in the offering are deemed to be "restricted securities" that are subject to resale limitations. In order to foster efficient capital formation, Congress, in NSMIA, prohibited the various States' securities regulators from reviewing private offering documents or imposing disclosure or merit limitations or restrictions on any so-called "covered securities" (including securities issued in Rule 506 transactions.) as well as with respect to certain other documents relating to covered securities.[3]

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2 Section 4(2) of the Securities Act provides an exemption from registration for any offering by an issuer not involving a public offering.

3 Although Congress did permit the States to impose "notice filing" requirements for Rule 506 offerings, such filing requirements are required to be substantially similar to those required by Rule 506 that existed on September 1, 1996 and, in addition, the States are permitted to receive a limited consent to service of process, an annual or periodic sales report, and a filing fee, but "solely for notice purposes." Under Section 18 of the Securities Act, however, the States are not permitted to seek a copy of any offering materials for review or otherwise with respect to any Rule 506 offering (or any other covered securities offering which does not require a filing of such materials with the SEC). See Sections 18(b)(4)(D) and 18(c)(2)(A) of the Securities Act.

Prior to the enactment of NSMIA, various States' securities regulators had effected a hodgepodge of rules and regulations that applied to Rule 506 offerings that, for the most part, lacked a high degree of uniformity or consistency among such States. As a result, capital formation through private offerings, which should have been efficient and relatively free from regulation, was complex, and often lengthy and expensive. NSMIA represented a clear Congressional intention to change this situation.

In this regard, FINRA (including through the former National Association of Securities Dealers, Inc.) did not, and has not, historically adopted rules or regulations relating to the conduct of private offerings, such as in Rule 506 offerings. FINRA acknowledged its more limited role in the regulation of private offerings when it issued Regulatory Notice 10-22 in 2010. In that notice, FINRA reminded members that even though Regulation D private offerings are not subject to registration under the Securities Act (or to filing and review by FINRA under FINRA's Corporate Financing rules), members must, nonetheless, be cognizant of their regulatory responsibilities to conduct adequate due diligence on the offering, and to ensure the adequacy of disclosures in any offering document, including from a customer-specific suitability perspective. Pursuant to such notice, FINRA stated that a breach of this due diligence duty could constitute a violation of the antifraud provisions of the Securities Act, particularly Section 17(a) of the Securities Act, as well as Section 10(b) of the Exchange Act. While it is not clear that this statement with respect to liability will find support in the courts, FINRA stopped short – well short - of imposing any filing, review or substantive requirements on the conduct of private offerings that are offered or sold by or through member firms (or their associated persons). See, for example, SEC v. Tambone, 550 F.3d 106 (1st Cir. 2010) (First Circuit declined to expand the scope of liability under Rule 10b-5(b) under the Exchange Act to statements impliedly made by underwriters).

Moreover, FINRA already has adequate rules designed to ensure the fair treatment of customers who invest in private offerings; for example, FINRA's suitability rule, NASD Rule 2310 (which will be replaced, and expanded, later this year by new FINRA Rules 2090 and 2111).

As noted above, we believe that the proposed amendments to the Rule would represent an unjustified and substantial departure from the historic treatment of private offerings by FINRA, especially private offerings conducted pursuant to Section 4(2) of the Securities Act and Rule 506 of Regulation D, and could significantly impede the capital formation process. Our concern is enhanced by the consequences of the financial crisis we have recently experienced, which have significantly affected the ability of private companies and investment funds to raise capital. The effect of the proposed amendments to the Rule would impede the private offering process by reason of the burdens and delays associated with the disclosure and review process, and would also increase the costs of raising capital. In addition, the proposals would increase the potential liability of broker-dealers. These effects will be especially felt by small businesses, which have been generally precluded from traditional sources of bank or credit financing, and small investment funds, which typically raise capital from fund investors. We do not believe this additional layer of protection is necessary or advisable, especially in view of the greater protections available to investors through recent SEC rulemaking and federal statutes, including the increased regulation of private investment funds pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") and the Private Fund Investment Advisers Registration Act of 2010. Further the SEC's recently proposed Form PF, which would require additional disclosure from certain registered investment advisers, would provide additional investor protections. As a result of these other initiatives, and the clear Congressional mandate not to encumber the private offering process, we urge FINRA not to expand the scope of the Rule beyond member private offerings.

(2) Definition of the Term "Private Placement":

Pursuant to FINRA Rule 5122(a)(5), the term "private placement" means a "non-public offering of securities conducted in reliance of an available exemption from registration under the Securities Act." In light of FINRA's focus on the private placement market as set forth in the Notice, we suggest that the term "private placement" in FINRA Rule 5122(a)(4) be amended to mean any offering that is conducted in accordance with Sections 4(2) or 4(5) of the Securities Act, Rule 506 of Regulation D under the Securities Act, or any offering of securities that are subject to the limitations on resale in Rule 502(d) of Regulation D under the Securities Act.

(3) Application of the Rule to Any "Participating" Member:

The Rule, as amended, would apply to any member or associated person who "participates" in a private placement of securities, absent an available exemption, and would use the definition of the term "participation" in FINRA Rule 5110(a)(5). Currently, the Rule applies only if a member or associated person of a member "offers or sells" any securities in a member private offering.

The term "participation" in FINRA Rule 5110(a)(5) is broader than merely engaging in the offer or sale of securities, and includes, for example, any member or associated person who provides "advisory or consulting" services to an issuer or who is involved in the preparation of the applicable private placement memorandum or term sheet, but who is not necessarily involved in the offer or sale of the securities of such private placement. For example, the term "participation," as defined in FINRA Rule 5110(a)(5), could possibly encompass a member who engages in capital introduction activities whereby such member introduces investors interested in investing in privately-offered hedge funds (and their hedge fund managers) seeking investors. The capital introduction provider, who is usually part of the prime brokerage business of a member, identifies investment advisers who pursue investment strategies that might be of interest to particular investors whereby such capital introduction provider may arrange for meetings of investors and investment advisers by sponsoring industry conferences with advisers as speakers or arranging one-on-one meetings between investors and investment advisers. Capital introduction providers, however, are not hired, engaged or retained by investment managers/advisers to raise money from investors, and capital introduction providers do not recommend any particular funds or engage in investor solicitation – they merely arrange for opportunities for investors to meet with investment advisers of funds. Also, if a member provides a fairness opinion to, or otherwise consults with, the issuer in connection with a merger and acquisition transaction, but which member is not otherwise selling the securities offered in the private offering, such member would be deemed to be "participating" in the private offering that would trigger the filing and other requirements of the Rule, absent the availability of an exemption.

FINRA states in the Notice that the Rule plays an important part in the effort to protect investors in the private placement market, but that the Rule does not currently address private placements in which the issuer is neither a FINRA member nor a control entity of such member. In this regard, FINRA notes, in endnote 6 to the Notice, that it has issued guidance concerning a broker-dealer's responsibilities with respect to private placements in April 2010 via Regulatory Notice 10-22, as noted above, and "which reminds broker-dealers of their regulatory obligations under FINRA's suitability rule and the anti-fraud requirements of the federal securities laws to conduct a reasonable investigation of the issuer and securities they recommend in private placements" – focusing on the offer and sale of the securities in question by a member whether or not involving securities of such member. As such, we believe that the proper focus or scope of the Rule should be on the offer and/or sale of securities, and not more broadly on other activities that may not involve the member in such offer or sale, but which activities, nonetheless, could come within the concept of "participation" under FINRA Rule 5110(a)(5).

(4) Proposed Disclosure of Affiliation under FINRA Rule 5122(b)(1)(A)(iii):

Under the proposed disclosure requirements of proposed FINRA Rule 5122(b)(1)(A)(iii), the applicable private placement memorandum or term sheet must disclose, if applicable, "that the issuer and any participating broker-dealer are affiliates and the nature of the affiliation." In this regard, FINRA proposes to add definitions of "affiliate" and "control," where the term "control" has the meaning set forth in FINRA Rule 5121(f)(6), and where the term "affiliate" would mean a company that controls, is controlled by or is under common control with a broker-dealer.[4]

The definition of "control" in FINRA Rule 5121(f)(6), however, employs a non-standard and broad definition of "control" that, for example, can establish "control," and thus affiliation, with a passive ownership interest in certain non-voting securities or the subordinated debt of another person/issuer, including with respect to a person who has the right to receive such non-voting securities/subordinated debt within 60 days after the offering. The requirement to disclose any such passive ownership relationship as constituting "control" or "affiliation" would not normally be viewed by investors as conferring control or affiliation.

Although such a broad, and non-standard, definition of "control," and thus "affiliate," between a participating member and an issuer may have more regulatory relevance in the context of establishing the need for the pricing of a public offering by a "qualified independent underwriter," as set forth in FINRA Rule 5121 (a "QIU"), the Rule (and the proposed amendments to the Rule) do not (would not) impose a QIU-type pricing requirement, and as such, the proposed expanded concept of "control" and "affiliation" is less relevant in the context of disclosure in a private offering that is limited in scope, as described above. Moreover, as

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[4] Although the term "broker-dealer" is not defined in the Rule, currently or as proposed to be amended, and there is no general definition of the term "broker-dealer" in FINRA's rules or by-laws, the terms "broker" and "dealer" are defined in Article I, sections (e) and (k), respectively, of FINRA's by-laws.

discussed under part (1) above, any special disclosure requirements that are mandated by FINRA in respect of a private offering of securities and that differ from the requirements under the Securities Act, such as the information requirements set forth in Rule 502(b) of Regulation D thereunder, would establish an inconsistency with the treatment of private offerings under the Securities Act that has worked well over the years.

In any event, any use of proceeds that would be paid to a selling member or an affiliate thereof would, presumably, need to be disclosed in the applicable offering document.

As such, we suggest that FINRA not impose under the Rule any special disclosure requirements that differ from the disclosure requirements applicable under the Securities Act, but at the very least, FINRA should use a definition of "control," and thus "affiliate," for these purposes that is consistent with the Securities Act, such as the definitions of "control" and "affiliate" set forth in Rule 405 under the Securities Act.[5]

(5) 85% of Gross Offering Proceeds Must Be Used for "Business Purposes."

Under FINRA Rule 5122(b)(3), at least 85% of the gross offering proceeds of a private offering must be used for "business purposes." FINRA states that although the Rule does not impose any specific limits on the total amount of offering costs and underwriting compensation that may be payable to a member, no more than 15% of the money raised from investors in a private placement could be used to pay offering costs, discounts, commissions or other compensation to participating broker-dealers or their associated persons.

The Rule would, therefore, not only impose a limit on the amount of compensation payable to a participating broker-dealer and its associated persons, but also would limit the amount of offering costs that an unaffiliated issue could elect to incur in connection with a private offering. In addition to being an unwarranted intrusion into the disclosure under, and merits of, private offerings, as described above, we do not believe that FINRA has the statutory jurisdiction over a non-member/issuer's use of proceeds other than, perhaps, with respect to payments to members and their associated persons (regulating the amount of compensation that a member and its associated persons are permitted to receive).

We, therefore, recommend that FINRA Rule 5122(b)(3) be limited to allowing a member and its associated persons to receive up to 15% of the gross proceeds of a private offering as compensation, but not otherwise imposing any limit on how much of the proceeds of a private offering that an unaffiliated issuer is permitted to spend. We also recommend that FINRA exclude from compensation for these purposes the exceptions from "item of value" set forth in FINRA Rule 5110(c)(3)(B) and that, consistent with FINRA Rule 5110(d) and (b)(6)(A)(vi)(b), FINRA not include for these purposes any items of value, as defined in FINRA Rule 5110(c)(3),

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[5] Rule 405 of the Securities Act defines the term "control" to mean "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." In addition, Rule 405 defines the term "affiliate" of a specified person as a person "that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified."

received by a participating (selling – see our comments in subpart 4 above) member more than 180 days prior to the commencement of the private placement or more than 90 days after the commencement of such offering.

In addition, we believe that the 85% limitation of FINRA Rule 5122(b)(3) should not include the payment of trail commissions to appropriately registered sales personnel of member firms. In 2004, through the issuance of Notice to Members ("NTM") 04-50, FINRA changed its previously long-standing policy of excluding from the 15% underwriting compensation (and all other offering expenses) limitation of NASD Rule 2810 (now, FINRA Rule 2310), relating to the offering of public direct participation programs, trail commissions paid in connection with public offerings of commodity pool programs. As a result, many programs which sought to continue to pay trail commissions ceased offering public programs and, instead, limited their offerings/programs to a private placement basis in accordance with Rule 506 of Regulation D under the Securities Act. Although a private offering of a commodity pool program that is operated by a commodity pool operator, as defined in Section 1a(5) of the Commodity Exchange Act, is exempt from the Rule pursuant to section (c)(12) thereunder (to be renumbered as new section (c)(11)), many other privately-offered funds have also relied upon the ability to structure trail commission or fee arrangements. We submit that imposing a limit on the ability of private programs to pay trail commissions or fees to appropriately registered and supervised sales personnel of member firms, or to the member firms themselves, would be unduly prejudicial.

Also, registered investment advisers who manage or sponsor hedge fund-of-funds products, and are affiliated with one or more FINRA members which may be involved in the offer/sale of such hedge fund products, may receive ongoing product-level fees or retrocession fees from the underlying fund managers - equal to a portion, or percentage, of the underlying manager's management or performance fee – in connection with the administration of such fund-of-funds products. These fees are paid on an ongoing, or "trail-like" basis, but such fees are more appropriately characterized as advisory or administrative/servicing fees than related to the offer/sale of the fund interests. We believe such fees should, similarly, not be included in the 85% limitation of FINRA Rule 5122(b)(3).

Finally, we believe that an 85% limitation may be too restrictive to cover issuer expenses for smaller offerings – gross offerings of less than $15 million – and that the requirement for such smaller offerings should be 75%.

(6) Correction of Errors:

FINRA Rule 5122(b)(4), entitled "Correction of Errors," would require that if a member firm or associated person thereof discovers, after the fact, that one or more of the conditions set forth in the Rule have not been met with respect to a private offering that is subject to the Rule, such member/associated person "must promptly conform the offering to comply with this Rule."

It is not clear what "conform the offering" means or would require of a member firm/associated person. Unlike the situation where a member firm is the issuer in a private placement or a control affiliate of the issuer, member firms who are hired by unaffiliated issuers to solicit prospective investors in connection with private offerings of such unaffiliated issuers will likely not have the ability, contractually or otherwise, to impose or force an issuer to alter/change or "conform" the offering other, than perhaps, to terminate the member’s selling arrangement with the issuer in accordance with the terms of the particular selling/placement agreement.

As such, we would suggest that the requirements of FINRA Rule 5122(b)(4) be limited to the situation where a member firm is the issuer or is acting as a selling agent for a control affiliate of the member firm.

(7) Filing Requirement Under The Rule

The Notice states that under the proposed amendments, as well as under the current rule, if there is a private placement memorandum or term sheet (an "offering document") in respect of a private placement (where such private placement is not eligible for an exemption under subpart (c) of the Rule), then such offering document would have to be filed with FINRA only at or prior to the first time the offering document is provided to any prospective investor and, thus, the amended rule "would not impose any delay in the offering." In addition, such offering document would have to be provided "to each prospective investor" and must contain specified disclosures.

Notwithstanding the foregoing, however, the Notice goes on to state that "[o]f course, if FINRA staff determines that an offering document presents an apparent investor protection issue, the responsible member should expect FINRA staff to contact the broker-dealer concerning the matter, whether or not the offering has already commenced" (or terminated). In this regard, we understand that FINRA will likely not review most offering documents that are required to be filed under the Rule, and will likely not review any such offering documents until after the commencement, and possible completion, of the offering in question. In addition, we understand that FINRA does not plan to issue the equivalent of a "no-objections" letter/opinion as it is required to do in connection with a public offering that is subject to filing under FINRA Rule 5110.

As a practical matter, it would not be advisable for an issuer to commence a private placement involving the offer/sale thereof by a FINRA member unless the member has received assurance that (i) FINRA has completed its review of the related offering documents (and has no comments or has comments that FINRA has communicated to the member and the member has resolved with FINRA) or (ii) FINRA will not issue comments after a specified period of time after the filing of the offering documents with FINRA, for example, after five (5) business days, and such time period has elapsed. Otherwise, members, and issuers, will face risk that they may receive formal comments from FINRA questioning the adequacy of the disclosure in an offering document after completion of sales in the offering, thereby, exposing such issuers and members to substantial liability (and potential enforcement risk by FINRA in the case of a member). Although under FINRA Rule 5122(d), FINRA shall accord confidential treatment to all documents and information filed by a member 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, the Rule does not appear to afford similar confidential treatment to any comment or similar letters issued by FINRA thereunder and that could be discovered by a litigant through appropriate legal action.

Faced with such risk, issuers may elect to forego private offerings through FINRA members (and might instead resort to unregistered "finders") and FINRA members may elect to cease private offerings, except offerings that come within one or more of the exemptions set forth in FINRA Rule 5122(c). The latter could have a chilling effect on capital formation, especially for small businesses.

As noted above, FINRA Rule 5122(b)(1) would require that if there is an offering document being used in connection with a private offering, such offering document must be provided to "each prospective investor." However, pursuant to Rule 502(b)(1) of Regulation D, in the case of a private offering conducted pursuant to Rule 506, an issuer is not required to furnish any specific information to accredited investors – only to non-accredited investors at a reasonable time prior to sale. Thus, with respect to a Rule 506 offering involving both accredited and non-accredited investors, FINRA Rule 5122(b)(1) would have the effect of superseding the Securities Act, which we believe is beyond the scope of FINRA's statutory authority. Alternatively, the Rule could encourage issuers to limit offerings to accredited investors and, thus, discourage the use of offering documents.

In light of the fact that in private offerings may not be offered by means of general solicitation or general advertisement; securities may generally not be sold to more than 35 investors who do not qualify as accredited investors; the issuer must generally comply with the information requirements of Rule 502(b) of the Securities Act; and a FINRA member is subject to substantial supervisory obligations under Regulatory Notice 10-22, as noted above, we believe that there is no need to establish a separate filing requirement for private offerings. In this regard, if FINRA does not propose to review all filings as they are received (but reserves the right to review such filings at its pleasure), and will not issue any formal "no-objections" letter/opinion, then a separate filing requirement seems superfluous to FINRA's examination authority that it already enjoys with respect to member firms, whereby, FINRA undertakes periodic examinations of member firms' business activities. However, if FINRA does establish/continue a filing requirement under the Rule, we believe that FINRA should make it clear that it has a limited period in which to review and provide comments on any filing required to be submitted under FINRA Rule 5122 – not more than five (5) business days from the date of submission of the filing to FINRA.

(8) Exemptions:

(i) FINRA Rule 5122(c)(1) provides, and the amended Rule would provide, an exemption for offerings sold "solely to" certain enumerated categories of investors in subsections (A) through (F). For example, subsection (A) relates to institutional accounts, as defined in NASD Rule 3110(c)(4) and subsection (B) relates to qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940 (the "1940 Act"). FINRA Rule 5122(c)(9) would provide an exemption for offerings to employees and affiliates of the issuer or its control affiliates. In addition, FINRA Rule 5122(c)(2) through (13) would provide exemptions for certain enumerated categories of offerings; for example, FINRA Rule 5122(c)(4) would provide an exemption for offerings of exempt securities with short-term maturities under Section 3(a)(3) of the Securities Act.

We believe that FINRA should clarify that all of the exemptions set forth in FINRA Rule 5122(c) may be combined with respect to any particular offering and, that, for example, a single offering made to (a) institutional accounts, as defined in NASD Rule 3110(c)(4) (in accordance with FINRA Rule 5122(c)(1)(A)), (b) qualified institutional buyers, as defined in Rule 144A under the Securities Act (in accordance with FINRA Rule 5122(c)(1)(C)), (c) qualified purchasers, as defined in Section 2(a)(51)(A) of the 1940 Act (in accordance with FINRA Rule 5122(c)(1)(B)) and/or (d) employees and affiliates of the issuer or its control entities (in accordance with FINRA Rule 5122(c)(9)) would be exempt from the requirements of the Rule, even though an offering may not be made "solely" to any single category of the investors above.

(ii) We believe that there should be a separate exemption for offers/sales to "knowledgeable employees", as defined in Rule 3c-5 under the 1940 Act. Although, FINRA Rule 5122(c)(9) would provide an exemption for offerings to employees and affiliates "of the issuer or its control entities", it is not clear that a person who qualifies as a knowledgeable employee of an investment manager of a hedge fund would necessarily qualify as an employee "of the issuer" or a "control entity" of the issuer. For example, an employee of an investment manager to an offshore fund with a board of directors may not be deemed to be either an employee "of the issuer" or a "control entity" of the issuer (as the issuer could be deemed to be controlled by its board of directors).

(iii) We also believe that there should be a separate exemption to allow offers/sales by a member of securities, in a private placement, to another Exchange Act-registered broker-dealer in connection with the establishment of a "joint back office" ("JBO") arrangement in accordance with Section 220.7 of Regulation T under the Exchange Act. In this regard, Section 220.7(c) of Regulation T permits an Exchange Act-registered broker-dealer to obtain "good faith" margin from another broker-dealer through a broker-dealer credit account, where the borrower/broker-dealer is an "owner" of the lender/broker-dealer, and where the lender is a clearing and servicing broker-dealer that is owned jointly or individually by other broker-dealers, including any borrower. Clearing broker-dealers that provide JBO financing typically do so by issuing a nominal amount of non-voting preferred securities in a private offering in order to establish a satisfactory ownership arrangement with an introducing firm. Such a private offering, however, is not intended for capital-raising purposes and should not raise the same concerns that the Rule is intended to address.

(iv) Although we understand that FINRA will not entertain a general exemption from the application of the Rule for offerings solely to "accredited investors," as defined in Rule 501(a) of Regulation D (including as recently amended, in certain cases, by the Dodd-Frank Act), we recommend that FINRA include a "de minimis" exemption for an offering that would allow a limited number of accredited investors or other non-exempt investors. In this regard, we would suggest an exemption for offerings in which at least 90% of the offering proceeds are raised from sales of securities to investors who meet any of the applicable exemptions under FINRA Rule 5122(c) (see our comment under subpart 8(i) above), and the remaining amount of offering proceeds are raised from the sale of securities to other investors. As suggested, if 90%

of the proceeds are raised from the types of investors identified in subparagraph (c) of the Rule, then FINRA should view this result as providing sufficient investor protection with respect to the limited number of "other" investors.

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Once again, the Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with FINRA and its staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
Jeffrey W. Rubin
Chair, Federal Regulation of Securities Committee

Drafting Committee:

David M. Katz
Mark Lab