March 14, 2011

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: FINRA Regulatory Notice 11-04--Extension of FINRA Rule 5122 to All Private Offerings

Dear Ms. Asquith:

The Capital Markets Committee (the "Committee") of the Securities Industry and Financial Markets Association[1] appreciates the opportunity to comment on the proposed amendment to FINRA Rule 5122 (the "Rule" and the proposed amendment, the "Revised Rule") set forth in FINRA Regulatory Notice 11-04 (the "Notice"), which would extend the application of the Rule to all private offerings in which a member participates. Specifically, a member participating in the distribution of a private offering, other than those offerings or sales exempt under the Revised Rule, will be required to file a private placement memorandum or other offering document with FINRA's Corporate Financing Department for post-offering review. In addition, the offering document will be required to disclose the intended use of offering proceeds, amount of offering expenses and amount and type of sales compensation payable to participating members. Finally, at least 85% of the proceeds of any offering subject to the Revised Rule must be used for the business purpose disclosed in the offering document and not for offering costs or compensation to participating members.

The Committee understands FINRA's desire to prevent fraud and abuse in the private offering market by extending the protection afforded by the Rule to all private offerings. However, the Committee believes FINRA should consider amending the Revised Rule to regulate members' participation in private offerings, rather than requiring issuers, or members to compel issuers to use a certain percentage of offering proceeds for business purposes. In this connection, we

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit www.sifma.org.

would propose that members be prohibited from receiving sales compensation in excess of 15% of gross offering proceeds, which would in turn require issuers to use the remaining 85% of the offering proceeds for another purpose. Unlike current Rule 5122, FINRA will have no jurisdiction over the vast majority of issuers subject to the Revised Rule because they will have no affiliation with a FINRA member. Accordingly, FINRA will be unable to take enforcement action for violations of the Revised Rule by such issuers.

The Committee also believes that rather than exempting numerous classes of offerings from the requirements of the Rule, the Revised Rule should be limited to offerings in which the abuses cited in the Notice may be present, specifically offerings made in reliance upon section 4(2) of the Securities Act of 1933, as amended (the "Securities Act") and Regulation D thereunder to persons who are not accredited investors. If FINRA is uncomfortable with this approach, the Committee believes there are additional classes of offerings that should be exempt from the Revised Rule because of the sophisticated nature of the purchasers, information is publicly available regarding the issuer and/or other safeguards are in place.

The Committee commends FINRA for proposing post-offering review rather than pre-offering review of private placement memoranda. Given FINRA's presumed resource constraints, we believe it is important not to add significantly delays to an issuer's ability to access private capital. Post-offering reviews do however pose a set of issues with respect to breaches, remedies and related liabilities. We encourage FINRA to provide guidance on the envisioned process should a compliance issue arise in a post-offering review. As a starting point, the Committee believes the Corporate Financing Department should contact members regarding offerings they believe to be non-compliant, rather than delegating this function to FINRA's enforcement division.

Proposal for Revising Scope of the Rule and Additional Exemptions

As stated above, the Committee believes the Revised Rule should regulate members rather than issuers over whom FINRA has no authority. In addition, the Rule should not be applicable to offerings "that do not raise the concerns raised by previous FINRA enforcement actions."[2] Those actions have been brought for, among other reasons, unsuitable sales by registered representatives, including sales to unsophisticated individuals or individuals incapable of bearing the risk of loss of their investment.

The Committee believes the only offerings that may raise these concerns are offerings made in reliance upon Regulation D or section 4(2) of the Securities Act to persons who are not accredited investors. Accordingly, we would propose that the Revised Rule be limited to such offerings. As more fully described below, we believe the changes to Regulation D resulting from the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), specifically the addition of "bad boy disqualifiers," will eliminate the ability of bad actors (i.e., the type of persons against whom FINRA has taken enforcement action) to rely on Regulation D in connection with private placements. The protection of the Revised Rule would therefore not appear necessary for Regulation D offerings to accredited investors. Because of uncertainty as to the exempt status of an offering under the Securities Act, sponsors do not generally rely upon section 4(2) for a private offering unless the offering is made to institutional investors or extremely high net worth individuals. In a situation where a 4(2) offering is made almost exclusively to such purchasers but also, for example, to a few executive officers or directors of

[2] FINRA Regulatory Notice 09-27.

the issuer (i.e., accredited investors), the protection of the Revised Rule would also not seem necessary,

If FINRA is uncomfortable adopting this approach, the Committee suggests that “private placements” be defined under the Revised Rule as offerings made in reliance upon section 4(2) of the Securities Act or Regulation D and that exemptions be expanded to include (i) offerings made in compliance with Rule 506 of Regulation D sold to institutional accredited investors as well as a small number of accredited investors that are natural persons; (ii) offerings that require a minimum investment or commitment of $150,000 where such investment does not exceed 25% of the investor’s liquid assets, (iii) offerings of issuers for whom information is publicly available and (iv) offerings to existing security holders of the issuer. For the same reason, we believe there should be an exemption in the Revised Rule for (i) sales to directors of the issuer or its control entities, (ii) sales to “knowledgeable employees,” as defined in the Investment Company Act of 1940 (the “1940 Act”) and (iii) sales made by issuers with the assistance of wholesalers that are not affiliated with the issuer and that do not engage, directly or through affiliates, in direct sales to investors.

I. Additional Exempt Offerings

Changes to Regulation D resulting from Dodd-Frank are making Regulation D offerings safer for investors. Specifically, Dodd-Frank directs the SEC to adopt rules by July 21, 2011 that disqualify certain “bad boys” from relying on the Rule 506 exemption under Regulation D (the exemption for offerings with unlimited offering proceeds) in a form that is substantially similar to the “bad boy” rules set forth in SEC Rule 262. As a result, the exemption in Rule 506 of Regulation D will be unavailable for an offering if the issuer, its predecessors or affiliates, as well as any of its directors, officers, general partners, promoters or any beneficial owner of 10% or more of any class of its equity securities is a bad boy, as defined. Rule 506 will also be unavailable if a participating member firm or any of its partners, directors or officers is a bad boy. Under Dodd-Frank, a bad boy is defined as a person (i) convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC, or (ii) subject to a final order of a regulatory body that bars the person from engaging in, among other things, the business of securities, insurance, or banking or constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the prior 10-year period. In addition, as a result of Dodd-Frank, the definition of accredited investor now excludes the value of an individual’s primary residence from the $1 million net worth test.

In light of the enhanced investor protection afforded by these changes, we believe FINRA should consider an exemption under the Revised Rule for offerings made under Rule 506 of Regulation D to all accredited investors. If FINRA is unwilling to make this change, we would propose an exemption from the Revised Rule for sales to an unlimited number of institutional accredited investors and a small number of accredited investors who are natural persons.

We also believe an exemption is merited for offerings that require an investor to make a minimum purchase of or commit to purchase $150,000 of securities, which investment or commitment does not exceed 25% of the investor’s liquid assets. This exemption should only be available if neither the minimum investment or liquidity requirement could be waived by the issuer. This proposal is based on exemptions from securities registration requirements in the blue sky laws of a number of states, reflecting the view of blue sky administrators that investors capable of making an investment of this size do not require the protection of state securities laws. We believe the protection afforded by the Revised Rule is also unnecessary for such purchasers.

We do not believe the Revised Rule should apply to offerings of issuers for whom information is publicly available. Accordingly, we would propose an exemption for an offering by an issuer that is a reporting company under the federal securities laws. This is consistent with the reduced disclosure requirements under the federal securities laws for reporting companies and exemptions under the blue sky laws for offerings of reporting companies.

Finally, we ask that FINRA consider an exemption for offerings to existing security holders of the issuer. The enforcement cases that FINRA has cited in regulatory notices relate to issuers about whom investors have little information and with whom they have no investment experience. We believe the protection of the Revised Rule is unnecessary for investors who have investment experience with an issuer.

II. Additional Exempt Sales

The Committee proposes that there be an exemption from the Revised Rule for sales to directors of the issuer. Other FINRA rules provide exemptions for purchases by a director of securities of the company on whose board he serves. For example, directors who are restricted persons, as defined under FINRA Rule 5130, are nonetheless permitted to purchase new issues if the sale is directed by the issuer.

The Committee also proposes an exemption for sales to knowledgeable employees, as defined in the 1940 Act. While the Revised Rule provides an exemption for offerings to employees and affiliates of the issuer or its control entities, it is not clear whether sales to a knowledgeable employee of an investment manager of an investment fund would fall within this exemption. As a technical matter, we would also recommend that the exemption in paragraph (c)(9) of the Revised Rule be moved to paragraph (c)(1).

Finally, the Committee proposes that FINRA consider an exemption for sales made by issuers with the assistance of wholesalers that are not affiliated with the issuer and that do not engage, directly or through affiliates, in direct sales to investors. This exemption, present in the original Rule, was withdrawn from the Revised Rule because of the participation by wholesalers affiliated with issuers in defrauding investors. If a wholesaler is unaffiliated with an issuer and has no contact with investors, we believe the abuses cited by FINRA in Regulatory Notice 11-04 will not occur.

Proposals for Technical Revisions

We urge FINRA to consider certain technical issues that have a significant substantive impact with regard to compliance with the Rule. These revisions include conforming the definitions in the Rule to definitions in the Securities Act that are applicable to private offerings, modifying the definition of "participation" so that it only applies to member firms who are involved in the offering at the time at which the offering document is drafted or distributed, revising the definition of compensation so that it is more meaningful to private investors, clarifying who is responsible for filing the offering document with FINRA if more than one member is participating in the offering and clarifying that it is permissible to rely on more than one exemption for a particular offering.

The Revised Rule requires the disclosure of any affiliation between the issuer and a member participating in the distribution of the offering, where an "affiliate" is defined as a person who controls, is controlled by or is under common control with another (consistent with the definition in Regulation D). However, there is a significant difference between the definition of control

under the Revised Rule, which is the definition in FINRA Rule 5121, and the control definition used for purposes of Regulation D, which is the definition in SEC Rule 405. Under FINRA Rule 5121, a person who has a passive economic interest in 10% or more of the outstanding common equity, distributable partnership profits or losses, subordinated debt or preferred equity of an entity is deemed to have control of that entity and therefore be an affiliate. Under SEC Rule 405, control is deemed to exist, and an affiliation is created, when one person has the power to direct or cause the direction of management of another. The Committee believes that the definition of control under SEC Rule 405 is far more relevant to investors than the control definition under FINRA Rule 5121 and easier to determine. For example, an affiliate of a member firm could unknowingly acquire a 10% indirect passive interest in the equity of an issuer by virtue of an investment in a fund of funds. Under FINRA Rule 5121, the member would be an affiliate of the issuer by virtue of this investment by the member's affiliate. From a diligence standpoint, we believe this poses an undue burden that is not justified by the informational benefit to the investor and therefore ask that FINRA consider this change.

The Revised Rule is applicable to any private offering in which a FINRA member participates. "Participation" has the meaning specified in Rule 5110(a)(5), which includes participation in a consulting or advisory capacity. The Committee believes it is unduly burdensome to impose a filing requirement upon a member who merely assists an issuer in an advisory or consulting capacity. This advice may be very limited in nature and may terminate long before the offering is marketed or even structured. By contrast, a member participating in marketing the offering will be involved in the offering process at the time at which the offering document is finalized. We believe it is appropriate to require the filing of such document by a member still engaged by the issuer and involved in the offering process. Therefore, we would suggest that the definition of participation be limited to a member participating in the marketing of the offering, consistent with FINRA Rule 5121 rather than FINRA Rule 5110, and not apply "when a member firm acts solely as a finder, consultant or advisor, given these capacities generally do not involve managing or distributing a public offering."[3]

The Revised Rule requires disclosure of the amount of compensation that will be paid to participating broker-dealers. Regulatory Notice 11-04 infers that compensation will be defined as it is in Rule 5110, which includes rights of first refusal granted to the member to participate in future offerings, securities acquired by members, their affiliates or associated persons within 180 days of the offering and expense reimbursements paid to the member in connection with offerings that were not completed. While these items of value are relevant to the Corporate Financing Department's analysis as to whether excessive underwriting compensation is payable in connection with a public offering, we believe this definition may be overbroad in view of the regulatory purpose underlying the Revised Rule. We would therefore propose that compensation be defined to include certain cash fees payable in connection with the offering (e.g., discounts or commissions, reimbursement of members' expenses, including expenses of members' counsel, finder's fees and wholesaler's fees) but not rights of first refusal, securities acquired by members and related persons and financial advisory fees unrelated to the distribution of the offering.

The Committee would appreciate clarification as to who will be responsible for filing an offering with FINRA under the Revised Rule when multiple members are participating in the distribution of an offering. We would suggest that the Revised Rule provide that the lead underwriter/agent or a member designated by the underwriters/agents be responsible for the filing. In addition, we

[3] FINRA Regulatory Notice 09-49.

ask that the Rule provide that members may reasonably rely on an investor's representation that is the basis for an exemption (e.g., accreditation status). In offerings where more than one member participates, a member should not be responsible for determining whether an exemption is available with respect to the investors brought in by another member firm.

Finally, it would be very helpful if the text of the Rule included a statement that members may rely upon more than one exemption in connection with an offering. We realize that this statement appears in Regulatory Notice 09-27 but inserting it in the Revised Rule would eliminate any confusion as to the scope of the exemptions.

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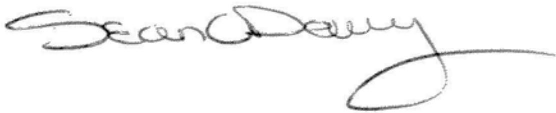
We appreciate this opportunity to submit our comments on the Revised Rule and we would welcome the opportunity to meet with FINRA staff to understand FINRA's objectives better and explain our views more fully. If you should have any questions or would like to discuss our comments, please do not hesitate to contact me at 212-313-1118 or sdavy@sifma.org or Marcie Goldstein, outside counsel, at (212) 450-4739 or marcie.goldstein@davispolk.com.

Sincerely,



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