MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 22, 2013

VIA EMAIL

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: FINRA Rule 5123 (Private Placements of Securities); File Number SR-FINRA-2013-026

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission's (the "SEC") notice of the Financial Industry Regulatory Authority's ("FINRA") proposed immediately effective amendments to Rule 5123.[2] The amendments would require FINRA members, in connection with the electronic filing of private placement materials pursuant to Rule 5123, to provide additional information to FINRA about the nature of the offering, the issuer, and affiliates of the issuer.[3]

For the reasons set out below, MFA respectfully submits that the proposed amendments to Rule 5123 would conflict with Section 15A(b)(6), Section 15A(b)(9), and Section 3(f) of the Securities Exchange Act of 1934 (the "Exchange Act"), and we recommend that the SEC disapprove the amendments. In addition, we respectfully disagree with designating the

[1] The Managed Funds Association ("MFA") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants.

[2] Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Members' Filing Obligations under FINRA Rule 5123 (Private Placements of Securities), Securities Exchange Act Release No. 69843 (June 25, 2013); 78 F.R. 39367 (July 1, 2013) (the "Release").

[3] The Form would include questions regarding: whether the offering is a contingency offering; whether independently audited financial statements are available; the use of offering proceeds; the issuer's board of directors or general partner; general solicitation activity; and disciplinary history of the issuer and affiliates.

amendments as immediately effective without providing affected parties an opportunity to provide comments prior to their adoption.

In our comments prior to the adoption of Rule 5123,[4] we explained that Rule 5123 conflicts with the long-standing regulatory framework for private fund offerings. The filing requirement is inconsistent with both Section 4(a)(2) of the Securities Act of 1933 (the "Securities Act"), which exempts private offerings from the registration requirement of the Securities Act, and Regulation D, which provides a safe harbor for issuers to comply with Section 4(a)(2). By requiring issuers to file additional information in connection with a private offering, the proposed amendments would extend the Rule even further over the dividing line that Congress has established separating public offerings from private offerings. In addition, the Rule makes private offerings more costly and less efficient, thereby imposing an unnecessary burden on capital formation. Accordingly, Rule 5123 conflicts with Section 15A(b)(6), Section 15A(b)(9) and Section 3(f) of the Exchange Act.[5]

Under Section 4(a)(2), an issuer that engages in a private offering is exempted from the requirement to file a registration statement with the SEC. Rule 5123 undermines this fundamental tenet of the securities laws by requiring private fund managers to file documents that are similar in form and substance to a registration statement. A private placement memorandum ("PPM") for a private fund, for example, provides a detailed description of the fund, including its investment objectives, risk factors, operating structure, subscription and redemption terms, fees and expenses, and other conditions.[6] This information is similar to the scope of information required to be included in a registered investment company's registration statement on Form N-1A. Requiring private fund managers to file this information with FINRA is inconsistent with Section 4(a)(2), and undermines the central distinction between public and private offerings.[7]

---

[4] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (June 29, 2012), available at: https://www.managedfunds.org/wp-content/uploads/2012/06/MFA-Comments-on-FINRA-Rule-5123-6-29-12.pdf; Letter from Stuart J. Kaswell, MFA, to Elizabeth Murphy, SEC (Feb. 27, 2012), available at: https://www.managedfunds.org/wp-content/uploads/2012/02/MFA_Comments_on_FINRA_Rule5123_2-27-2012.pdf; Letter from Stuart J. Kaswell, MFA, to Elizabeth Murphy, SEC (Nov. 14, 2011), available at: https://www.managedfunds.org/wp-content/uploads/2011/11/MFA_Comments_on_FINRA_Rule5123.pdf. We incorporate those comments by reference to this letter.

[5] Section 15A(b)(6) of the Exchange Act 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, 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. Section 15A(b)(9) provides that FINRA's rules must not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title. Section 3(f) of the Exchange Act requires the Commission as part of its review of a rule of a self-regulatory organization to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

[6] Of course, there is no SEC rule that explicitly specifies the need for, or contents of, a PPM. Issuers engaging in private offerings use PPMs to provide extensive information to potential purchasers. By its very nature, issuers and potential purchasers in a private offering do not need the mandated disclosures of a public offering.

[7] Most private funds use a PPM, and are therefore required to file it with FINRA pursuant to Rule 5123.

This conclusion is consistent with the SEC's long-standing position that an issuer conducting a private offering under Regulation D must only submit to the SEC and applicable state authorities a notice filing on Form D. Form D is designed to provide the SEC with appropriate identifying information about the offering; the Form does not require information of the type included in a registration statement or a typical PPM.[8] Requiring private funds to file such information with FINRA would conflict with the SEC's determination that under the securities laws, issuers conducting private offerings need only submit a notice filing on Form D. The SEC should maintain a single notice filing in connection with offerings made pursuant to Regulation D, consistent with the existing private offering framework.

The proposed amendments would erode this critical distinction by requiring an issuer conducting a private offering to file information. Under current Rule 5123, an issuer is required to submit to FINRA material, such as a PPM, that it has already prepared in conducting its offering. The amendments, however, would impose a new obligation on an issuer to complete the information requested in the Private Placement Form, irrespective of whether the issuer has prepared such information in the ordinary course of conducting the offering. This change in the nature of the obligation imposed on an issuer would make Rule 5123 indistinguishable from a filing requirement in connection with a private offering.

While we appreciate FINRA's obligation to oversee the activities of its members, it is inappropriate to seek to do so by imposing an extensive filing requirement on issuers conducting private offerings. FINRA should instead utilize its examination authority or other methods targeted at its members to ensure that they fulfill their obligations when participating in a private offering. Under FINRA's rules, members report to FINRA detailed information about their business practices, including the type of securities to be offered and sold, and the types of customers to be solicited.[9] These requirements already provide FINRA with appropriate information to evaluate whether its members are fulfilling their obligations when participating in private offerings. FINRA should use such information in overseeing its members, rather than impose burdensome disclosure obligations on issuers seeking to raise capital in a manner inconsistent with the fundamental statutory framework of the federal securities laws. Accordingly, because FINRA has other means of discharging its responsibilities, we believe that the new requirements are inconsistent with, among other provisions, Section 15A(b)(9) of the Exchange Act.

The timing and process of the proposed amendments also suggest that Rule 5123 has or will become a *de facto* registration requirement for private offerings. Soon after adopting Rule 5123, FINRA has proposed additional informational requirements that go beyond the original scope of the Rule. The amendments were not included in the notice and comment process that preceded the adoption of the Rule, and it was that process which served as the statutory basis for

---

[8] The SEC recently proposed amendments to Form D that are designed to provide the Commission with additional information about private offerings. Amendments to Regulation D, Form D and Rule 156 under the Securities Act, Securities Act Release No. 9416 (July 10, 2013).

[9] FINRA Rule 1013 (a)(1)(E)(v). FINRA members also must indicate on Form BD whether they are engaged in the business of private placements of securities. Question 12.

the SEC's approval of Rule 5123. We believe an appropriate comment period would be consistent with a fair and transparent regulatory process pursuant to the Exchange Act and other requirements.

The amended Rule would also conflict with the findings that the Commission must make under Section 3(f) of the Exchange Act, including whether the Rule would promote efficiency, competition, and capital formation. By requiring a FINRA member to provide due-diligence related information about the nature of an offering, the issuer, and affiliates of the issuer, the amendments would make private offerings more costly and less efficient, thereby imposing an unnecessary burden on capital formation. As noted, other regulatory requirements would permit FINRA to discharge its obligations under Section 15A of the Exchange Act, without the need for the additional burden that this proposal contemplates.

FINRA asserts that the rule change is "non-controversial" and would present only a modest filing burden because it would not impose an obligation on a member to seek out information it does not already have.[10] A FINRA member that recommends a security, however, is under a duty to conduct a reasonable investigation concerning that security and the issuer's representations about it. FINRA has recently re-affirmed this obligation specifically in the context of private offerings made pursuant to Regulation D,[11] and explains that the additional information in the Private Placement Form will assist it in evaluating whether members are conducting such an investigation.[12] It is clear, therefore, that FINRA members are under an obligation to obtain some or all of the proposed information, and members will treat the information requests as a mandatory component of compliance with Rule 5123.

As explained in our previous letters, to comply with the Rule, a private fund engaged in an offering must coordinate with a FINRA member regarding the submission of information, leading to a potentially lengthy review process, difficulties in ensuring that appropriate filings were made, and liability concerns. These burdens and delays inhibit private funds from conducting offerings efficiently and obtaining capital to invest in the economy. Furthermore, the Rule imposes significant costs and business risks on private fund managers due to the proprietary nature of the information. Requiring broad distribution of this sensitive information by private fund managers to multiple FINRA members raises substantial confidentiality and competitive concerns. The proposed additional reporting requirements would add to these burdens.

These burdens increase the costs of engaging a FINRA member in connection with a private offering. A fund manager conducting a private offering needs to carefully evaluate whether these additional regulatory requirements and expenses are in the best interests of fund investors, or whether fund offerings instead could be conducted effectively in a manner that would not incur these burdens. In our view, the amendments further discourage issuers from using FINRA members to conduct offerings, and could therefore lead to a reduction in the use of broker-dealer firms in connection with private offerings. Such a reduction in the use of broker-

[10] The Form would permit a member to respond "unknown" to virtually all of the due-diligence questions. 78 F.R. at 39368.

[11] FINRA Regulatory Notice 10-22 (Apr. 2010).

[12] 78 F.R. at 39368.

dealers could create uncertainty for issuers and regulators, and would not further the policy objectives of the Rule.

Finally, we disagree with the waiver of the standard 30-day operative delay after the date of filing for a proposed rule change filed under Rule 19b-4(f)(6), and the lack of an opportunity for notice and comment prior to the effectiveness of the Rule. The Commission asserts that the burden on members imposed by the amendments is minimal because FINRA has already required that members file an abbreviated version of the Private Placement Form, and the amended Rule would not impose a duty on members to obtain information. As explained above, however, members are under a duty to conduct a reasonable investigation of private offerings, regardless of whether the amended Rule would itself impose such a duty. In addition, FINRA adopted the Private Placement Form through its Regulatory Notice 12-40 following the adoption of Rule 5123, and the Private Placement Form was not subject to a period of notice and comment. It is appropriate that any expansion of the Private Placement Form should be subject to a period of notice and comment.

For these reasons, we believe amended Rule 5123 would conflict with Section 15A(b)(6), Section 15A(b)(9), and Section 3(f) of the Exchange Act. We recommend that the Commission disapprove of the proposed amendments to Rule 5123, pursuant to Section 19(b)(2), which requires that the Commission approve a proposed rule change if it is consistent with the requirements of the Exchange Act and the rules thereunder that are applicable to such organization, and directs the Commission to disapprove a proposed rule change if it does not satisfy such standard. At a minimum, pursuant to its authority, the Commission should immediately suspend the Rule amendments and institute proceedings to determine whether the proposed rule should be approved or disapproved.

* * * * * * *

If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Newell, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: John Ramsay, Acting Director, Division of Trading and Markets, SEC
Norman Champ, Director, Division of Investment Management, SEC
Keith F. Higgins, Director, Division of Corporation Finance, SEC

Richard G. Ketchum, Chairman & Chief Executive Officer, FINRA
Robert L. D. Colby, Chief Legal Officer, FINRA
Racquel Russell, Associate General Counsel, FINRA