St. John's University School of Law

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Securities Arbitration Clinic

8000 Utopia Parkway
Belson Hall, 2nd Floor
Queens, NY 11439
Tel (718) 990-6930
Fax (718) 990-6931
www.stjohns.edu/law/sac

November 10, 2011

VIA ONLINE SUBMISSION

Elizabeth M. Murphy
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: SR-FINRA-2011-057
Proposed Rule Change to Adopt New FINRA Rule 5123 (Private Placements of Securities)

Dear Ms. Murphy:

The Securities Arbitration Clinic at St. John's University School of Law is very pleased to accept this opportunity to comment on the proposed rule change to adopt new FINRA Rule 5123 (Private Placements of Securities). The Clinic supports the proposed rule change because it is narrowly tailored to target non-institutional, retail private placements. The proposed rule change will increase disclosure, improve the transparency in the financial system, and serve to prevent fraud upon the market.

The Securities Arbitration Clinic is a not-for-profit organization that provides free legal representation to public investors, who are otherwise unable to obtain legal representation, in their securities disputes. The Clinic is staffed by fifteen second- and third-year law students. Our clients are generally of modest means and have been turned down by a minimum three attorneys. If the Clinic did not represent them, our clients would likely be forced to proceed *pro se* or not pursue their claims at all. In addition to representing aggrieved investors, the Clinic is committed to investor protection. Accordingly, we have a strong interest in rules that affect investors.

In the wake of the financial crisis of 2008, there has been increased public support for increased regulation and oversight. The domain of private placements has not escaped scrutiny, with even prominent large underwriters noting the potential for fraud.[1] Specifically, "the poor quality of pricing and information disclosure around private placements over the years has given rise to frauds such as pump-and-dump scams."[2] Because the market for private placement securities is much less liquid than traditional securities, FINRA has an interest in promoting awareness of these potential risks.[3] In this view, the proposed rule can serve as a powerful prophylactic measure, preventing fraud before it happens rather than wasting time and resources *ex post facto*.

The proposed rule as constructed presents no concerns. The first part, the disclosure requirement, provides needed information to investors. This component closely follows the disclosure requirements of Rule 5122, and does not pose significant adverse effects. Although it may be argued that the added disclosure requirements may result in increased costs on behalf of the member firm, these are *de minimis* in light of the potential benefit of the rule. Moreover, the potential increases are counterbalanced by the efficiencies provided by the proposed filing requirement. Also, FINRA's striking of the prior proposal's (Rule 5122) requirement that at least 85% of the proceeds of a Member Private Offerings be used for business purposes and that the use of proceeds be consistent with the disclosures in the private placement memo ("PPM"), term sheet, or other offering document, represents a significant willingness on behalf of FINRA to reduce administrative burdens. While it may be argued that the disclosure requirement would require FINRA members to draft disclosure statements in absence of disclosures provided by the issuer, this has the potential to both increase collaboration and uniformity.

The second element of the rule, the requirement that the PPM, term sheet, or other disclosure documents be filed with FINRA no later than 15 days after the first sale, is beneficial. It serves to expedite regulatory review, but also coincides with the timing requirement for the filing of Form D. This represents potential reductions in transactional costs and therefore an increase in operational efficiencies. This dually serves to both increase available information, while decreasing the burden on firms.

The third element of the rule, the exemptions, limit the effect of Rule 5123 to non-institutional, or retail, private placements. Because of the breadth of FINRA's jurisdiction, this effectively encompasses all non-institutional private placements. For us, this represents an acknowledgement of the problems that have developed in private placements. Private placements were originally designed as sophisticated tools for institutional investors, but due to anachronistic net-worth requirements for private placements,[4] they are now sold to individual investors and the elderly—persons who lack the financial sophistication to understand the risks

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[1] *See* Joseph A. Giannone, *FBR Boss Says Private Placements Not for Retail*, REUTERS, Mar. 2, 2011 ("Poorly vetted deals and insider-dealing have tainted this marketplace over the years, and regulators are cracking down on placements made to less sophisticated retail investors."), *available at* http://www.reuters.com/article/2011/03/02/us-finance-summit-fbr-placements-idUSTRE7216L520110302.

[2] *Id.*

[3] *Id.*

[4] The net-worth requirements for private placement eligibility have not been modified since 1982.

involved.[5] Particularly, in the modern economic climate with Federal interest rates pressed downward, more investors have been seeking higher yield investments in the securities market, creating micro-bubble economies.[6] Because private placements are riskier than publicly traded securities, private placement issuance has grown since 2008.[7] This growth has coincided with FINRA complaints.[8] Additionally, some companies have been specifically targeting the elderly because they have both capital and home equity.[9] In the interest of investor protection, increased transparency, and awareness, we support this rule proposal.

Thank you for the opportunity to comment on this proposed rule. We believe that the proposed adoption of rule 5123 is necessary to promote the availability of information to investors. We also believe it increases efficiency by acting as a preventative measure. We ask that the SEC approve this rule. Thank you for your consideration of this important matter.

Respectfully,

/s/ Ryan Adams

Ryan Adams
Legal Intern

/s/ Christine Lazaro, Esq.

Christine Lazaro, Esq.
Supervising Attorney, Securities Arbitration Clinic

/s/ Lisa Catalano, Esq.

Lisa Catalano, Esq.
Director, Securities Arbitration Clinic

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[5] Alexis Leondis, *Investors With 'Nowhere to Go' Lured by Private-Placement Yield*, BLOOMBERG, Nov. 19, 2010, *available at* http://www.bloomberg.com/news/2010-11-19/private-placements-luring-unsophisticated-investors-with-nowhere-to-go-.html.
[6] *See id.*
[7] *Id.* ("In 2008, companies planned to issue about $609 billion of private placement-related securities . . . .").
[8] *Id.* ("The number of complaints about private placements to [FINRA] increased 35 percent [in 2010] and more than 50 percent in 2009 . . . .").
[9] *See id.*