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November 9, 2011

Via E-mail: rule-comments@sec.gov

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

Re: Notice of Filing of Proposed Rule Change to Adopt New FINRA Rule 5123 (Private Placements of Securities), File Number SR-FINRA-2011-057, Release No. 34-65585 (Oct. 18, 2011) (the "Release")

Dear Ms. Murphy:

This letter is submitted on behalf of the Committee on Securities Regulation (the "Committee") of the New York City Bar Association in response to the request for comments by the Securities and Exchange Commission (the "Commission") to the proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA") to adopt new FINRA Rule 5123 (Private Placement of Securities) (the "Proposed Rule").

Our Committee is composed of lawyers with diverse perspectives on securities issues, including members of law firms and counsel to corporations, investment banks, investors and government agencies.

The Committee acknowledges and supports FINRA's goals of enhancing investor protection and combating fraud and other potential abuses in connection with private placement transactions. The Committee also appreciates FINRA's consideration of the Committee's and

other constituents' comments submitted in connection with the agency's earlier proposal to amend Rule 5122 in Regulatory Notice 11-04 (the "Rule 5122 Amendment Proposal"). In terms of striking an appropriate balance between investor protection concerns and practical business realities, the Committee believes that the Proposed Rule represents a more measured approach than that set forth in the Rule 5122 Amendment Proposal. That said, the Committee respectfully suggests that FINRA adopt certain modifications to, and clarify certain aspects of, the Proposed Rule to more closely reflect FINRA's goals without also imposing unnecessary burdens on capital formation. The Committee discusses more fully these aspects of the Proposed Rule below.

ANALYSIS OF THE PROPOSED RULE

THE DEFINITION OF "PRIVATE PLACEMENT" IN THE PROPOSED RULE IS OVERLY BROAD AND LARGELY UNWORKABLE

The Committee believes that, as currently drafted, the definition of "private placement" set forth in the Proposed Rule is overly broad and largely unworkable. Rule 5123(a) provides that "[n]o member or person associated with a member[1] may offer or sell any security *in reliance on an available exemption under the Securities Act* ('private placement')."[2] This formulation certainly encompasses the universe of federal exemptions from registration traditionally viewed as being "private placement exemptions" under the Securities Act of 1933 (the "Securities Act"): (i) Section 3(b)[3], (ii) Section 4(2)[4] and (iii) Section 4(5).[5] Offers and sales of securities relying on these exemptions (as well as any subsequent private placement exemption promulgated under the federal securities laws) are properly within the scope of the private placement transactions FINRA seeks to monitor in promulgating the Proposed Rule.

However, given that Rule 5123(a) speaks expansively of "an[y] available exemption under the Securities Act," the Proposed Rule would also appear to cover to a host of exemptions wholly unrelated to private placement transactions. For instance, one could reasonably construe this language to capture transactions involving securities exempt from registration under Section 3(a) of the Securities Act.[6] It also would appear to cover secondary transactions relying on other Section 4 exemptions from Securities Act registration, such as

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1 For ease of reference, references herein to "FINRA members" or "members" also includes associated persons.

2 Rule 5123(a) (emphasis added).

3 Section 3(b) of the Securities Act authorizes the Commission to exempt from registration certain relatively small offerings of securities.

4 Section 4(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering."

5 Section 4(5) of the Securities Act exempts from registration minimal amounts of offers and sales of securities to accredited investors if there is no advertising or public solicitation by the issuer.

6 Section 3(a) of the Securities Act exempts various categories of securities from registration under the Securities Act.

Section 4(3) (which exempts dealer transactions), Section 4(4) (which exempts unsolicited brokerage transactions executed on any exchange or in the over-the-counter market) and Section 4(1) (which exempts transactions by any person other than an issuer, underwriter or dealer). A seller's use of proceeds from such a resale of a security should not be of concern to the buyer of that security, nor would such use ordinarily be known to any FINRA member participating in the transaction.

Application of the various requirements of the Proposed Rule to these transactions would seem inappropriate and, in some cases, unworkable. In particular, the Proposed Rule is inconsistent with the following provisions of the Securities Act.

- Sections 4(3) and 4(4). Section 4(3) exempts dealers' transactions from registration. Section 4(4) exempts unsolicited brokerage transactions executed on a national securities exchange or in the over the counter market. These exemptions, along with the exemption provided by Section 4(1) (discussed below), allow for the existence of the secondary market for securities. These transactions are unrelated to private placements and typically do not involve a distribution of securities. They also would not involve the preparation of the sort of offering documentation that would be required by the Proposed Rule. We do not believe that FINRA intends by the Proposed Rule to regulate regular way secondary market trading, including trading in which FINRA members participate as brokers or dealers, but this is arguably the effect of the Proposed Rule's "private placement" definition.

- Section 4(1). Section 4(1) exempts transactions "not involving an issuer, underwriter or dealer." This exemption permits unregistered trading between investors with respect to already-issued securities without the involvement of a broker. The SEC has noted that this exemption is available for transactions that are not "distributions by issuers or acts of other individuals who engage in steps necessary to such distributions."[7] This exemption is also unrelated to private placements. If a FINRA member sells securities on a proprietary basis (and not as an issuer, underwriter or dealer), it is entitled to rely upon this exemption, and it would be unworkable to apply the Proposed Rule to such a sale.

- Section 3(a)(10). Section 3(a)(10) exempts from registration an exchange for securities, claims or property interests, where a court or authorized governmental entity, authorized by law to hold a hearing, has approved the fairness of the terms and conditions of the exchange following a hearing. We respectfully suggest that the Proposed Rule also does not seem appropriate or necessary in the context of Section 3(a)(10). In Section 3(a)(10) exchanges, investor protection is predicated not on the dissemination of a disclosure document, but rather on a fairness hearing regarding the transaction held by a bankruptcy court or similar governmental authority. Thus, as a matter of regulatory policy, there is no need for FINRA oversight in connection with Section 3(a)(10) transactions, nor are we

[7] Release No. 33-5223 (Jan. 11, 1972).

aware of any evidence that the protections mandated by this exemption have proven to be inadequate from an investor protection point of view.[8]

Similar issues exist with respect to analogous exemptions from the registration requirements of the Securities Act:

- Section 1145 of the Bankruptcy Code -- This provision of the federal bankruptcy code exempts securities issued in a court-approved reorganization plan that are not otherwise entitled to the exemption from registration afforded by Section 3(a)(10). We believe that applying the Proposed Rule to securities issued pursuant to this provision of the Bankruptcy Code would pose the same issues as described above with respect to Section 3(a)(10)-exempt securities. We also note that a related Bankruptcy Code provision states:

  > Whether a disclosure statement [for a reorganization plan] . . . contains adequate information is not governed by any otherwise applicable nonbankruptcy law, rule or regulation . . .."[9]

  We believe that this provision would render invalid the disclosure-related provisions of the Proposed Rule insofar as FINRA sought to apply them to issuances of securities pursuant to Section 1145.

- Section 3(a)(12) -- Section 3(a)(12) of the Securities Act exempts from registration equity securities issued by a bank or bank holding company pursuant to reorganization or similar transactions under applicable banking law, so long as certain other requirements are met. We believe that applying the Proposed Rule to securities issued pursuant to this exemption would pose similar issues to those described above with respect to Section 3(a)(10).

Given FINRA's goal of curbing abuses in the private placement market, the Committee believes that inclusion of these and other unrelated exemptions is an unintended consequence of the Proposed Rule's broad wording. Consequently, the Committee respectfully suggests that FINRA explicitly specify that the Proposed Rule, in its final form, relates only to transactions relying on the private placement exemptions named above (i.e., Section 3(b), Section 4(2) and Section 4(5)), as well as any subsequent private placement exemption promulgated under the federal securities laws. This would help ensure that the Proposed Rule

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[8] Also, as a practical matter, a Section 3(a)(10) transaction, in many cases, would not involve any proceeds (i.e., the transaction simply would involve an exchange of securities or delivery of securities in exchange for a release of claims).

[9] 11 U.S.C. § 1125(b).

does not unnecessarily burden ordinary trading activities and capital formation by inadvertently sweeping in a host of non-private placement transactions.

CERTAIN EXEMPTIONS CONTAINED IN THE PROPOSED RULE SHOULD BE CLARIFIED TO CONFORM TO EXISTING SECURITIES ACT EXEMPTIONS OR TO REFLECT MARKET PRACTICE

The Committee believes that certain of the exemptions contained in Rule 5123(c) should be clarified or modified, as discussed below.

- Rule 5123(c)(4)/Section 3(a)(3). The Committee agrees that offers and sales of commercial paper meeting the Section 3(a)(3) exemption should be exempted from the Proposed Rule, as provided by Rule 5123(c)(4). We respectfully suggest that this exemption should be expanded to cover the common practice of offering short-term debt securities that do not meet either the 270-day duration limit or the "current transaction" requirement imposed by Section 3(a)(3) pursuant to Section 4(2). These securities are commonly viewed as commercial paper, and are sold in the same manner and in the same markets. We respectfully submit that there is no evidence of the sort of abuse in this market that FINRA seeks to address with the Proposed Rule, and imposing the disclosure and filing requirements in a market that operates in the same manner as the Section 3(a)(3) market would introduce unwarranted inefficiency into an otherwise highly efficient market.[10]

  We believe that this concern could easily be accommodated by also exempting debt securities offered and sold by FINRA members pursuant to Section 4(2) so long as the maturity does not exceed 397 days and the securities are issued in minimum denominations of $250,000 (or the equivalent thereof in another currency). This maturity limit conforms to the limit imposed by Rule 2a-7 under the Investment Company Act of 1940, which governs the nature of securities that may be invested in by money market funds (the primary purchasers of such securities). The minimum denomination requirement, which is also common in this market, would address any concern that such securities could be sold to retail investors, notwithstanding the predominance of money market funds as purchasers in this market.

- Rule 5123(c)(8)/SEC Release No. 33-9245. Rule 5123(c)(8) provides an exemption from the Proposed Rule for "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." FINRA indicates that it has proposed such language to bring the Proposed Rule in line with the Commission's recent

[10] For example, in the commercial paper market offering memoranda are often delivered periodically, and rarely with each transaction.

removal of references to credit rating in certain rules and forms.[11] We note, however, that the language quoted above does not track the parallel language in SEC Release No. 33-9245, the release that implements the Commission's removal of the credit ratings references.[12] The Committee respectfully suggests that Rule 5123(c)(8) should read as follows:

> offerings of non-convertible debt or preferred securities that meet the transaction eligibility criteria for registering primary offerings of non-convertible securities on Forms S-3 and F-3.

THE PROPOSED RULE SHOULD NOT REQUIRE FINRA MEMBERS TO PREPARE, DISTRIBUTE AND FILE DISCLOSURE DOCUMENTS ON BEHALF OF NON-AFFILIATED ISSUERS

The Proposed Rule requires that participating FINRA members provide to private placement investors a private placement memorandum, term sheet or other disclosure document containing certain mandated disclosures.[13] Such FINRA members also must file these disclosure documents with FINRA.[14] We believe that the presumption underlying these requirements is that the issuer, in accordance with long-standing market practice, would prepare the required offering document.

However, if the issuer does not prepare a private placement memorandum or term sheet, the Proposed Rule would require a FINRA member to prepare a document containing the required disclosures.[15] As such, the FINRA member would inherit from the issuer primary responsibility for the disclosure documents to be provided to investors and FINRA in connection with the transaction. The Committee respectfully submits that requiring members to prepare and file these documents on behalf of non-affiliated issuers is inadvisable and could set a dangerous precedent for future FINRA or other rulemakings.

As a preliminary matter, it may be impractical and inefficient in many instances for members to be charged with gathering and providing the required information. For example, the Proposed Rule would require the member to provide information that includes, among other things, the anticipated use of the issuer's offering proceeds in the transaction.[16] In many cases, a member would not be in a position to know this information, and the issuer would be better

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[11] Release, p. 5, fn. 4.

[12] Release No. 33-9245 (Jul. 27, 2011).

[13] Rule 5123(a).

[14] Rule 5123(b).

[15] Rule 5123(a)(2).

[16] *See* Rule 5123(a)(1)(specifying the content of documents that must be provided pursuant to the Proposed Rule).

situated to provide it to the investors (and to FINRA). We also note that by shifting the responsibility for such information from the issuer to the FINRA member, the Proposed Rule may inadvertently incentivize issuers to forego preparing such disclosure information, as the FINRA member would be required to do so to participate in the transaction. Such a result could negatively effect, rather than enhance, the quality of disclosure to investors.

We believe that FINRA should honor historical practice in the capital markets and not require FINRA member firms to take on primary drafting responsibility for issuer disclosure documents.[17] This allocation is appropriate given the issuer's superior knowledge of and access to the relevant information. We believe that shifting drafting responsibility in this manner may also shift potential liability for the accuracy and adequacy of the disclosure from the issuer to the FINRA member that prepared it.

Thus, instead of requiring FINRA members to prepare such information, the Committee respectfully submits that the Proposed Rule should prohibit a member from participating in a private placement transaction that is subject to the Proposed Rule if the issuer fails to produce the mandated disclosure. As a practical matter, the alternative disclosure scheme contained in the Proposed Rule may result in the same outcome in most cases, because a well-advised FINRA member would not likely participate in a private placement transaction in which the issuer declined to provide required information. However, as currently drafted, the Proposed Rule potentially creates a dangerous precedent of imposing traditional issuer drafting responsibilities, and liabilities, on FINRA members. The Committee believes that adopting the modification described above would prevent this undesirable precedent while achieving the same ultimate result -- investors will not be asked to invest in private placements without receiving the disclosure about the issuer mandated by the Proposed Rule.

THE APPLICATION OF THE PROPOSED RULE TO M&A TRANSACTIONS IS UNCLEAR

In response to the Rule 5122 Amendment Proposal, the Committee commented to FINRA that such proposal failed to specify the extent to which the amendments would apply to an M&A transaction structured as a stock sale.[18] Prior to soliciting comments on the Proposed Rule, it appears that FINRA considered crafting an exemption for M&A transactions.[19] In addition, in the Release, FINRA acknowledges the Committee's comments regarding M&A

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[17] In the registered offering context, this distinction is reflected by Section 11's strict liability standard for issuer liability, whereas underwriters are entitled to a due diligence defense.

[18] *See* Comment Letter of the Committee in Response to the Proposed Amendments (Mar. 14, 2011), p. 7-8.

[19] *See* FINRA to Repropose Rule Addressing Participation of Broker-Dealers in Private Placements, Morrison & Foerster News Bulletin (Apr. 18, 2011), *available at* http://www.mofo.com/files/Uploads/Images/110418-FINRA-Rule-Private-Placements.pdf. This news bulletin discusses the American Bar Association Business Law Section's Spring 2011 Meeting at which FINRA representatives apparently indicated that FINRA would repropose amendments to Rule 5122 and possibly include an exemption for M&A transactions.

transactions.[20] Notwithstanding this acknowledgement, FINRA concluded that a specific exemption for such transactions is unnecessary because "the exemptions in the proposed rule are appropriately tailored and inclusive, and . . . are very similar to those in existing Rule 5122."[21] FINRA also cited its experience with Rule 5122 to support its belief that additional exemptions are not needed.[22]

Despite FINRA's statements regarding its determination not to provide a specific exemption for M&A transactions under the Proposed Rule, it remains unclear how to apply the Proposed Rule with respect to such transactions. The Committee is unaware of any interpretative guidance under Rule 5122 that would inform the application of the Proposed Rule to M&A transactions. Absent such guidance, the Committee believes (as it did with respect to the Rule 5122 Amendment Proposal) that application of the Proposed Rule in the M&A context is inapposite and unworkable. Among other things, the Committee identified the following issues limiting the applicability of Rule 5122 to M&A transactions, which issues also would relate to the Proposed Rule: (1) the concept of "proceeds" does not apply in the M&A context and thus, there can be no description of the use of such proceeds and (2) disclosure of member fees (which fees may be viewed as competitively sensitive information) in M&A transactions is not a customary business practice.[23] We also believe that imposition of the Proposed Rule on M&A transactions will create inefficiency and added cost that is not justified by any regulatory or other benefits.

Rather than provide a specific exemption for M&A transactions, FINRA suggests in the Proposed Rule that members may apply for transaction-specific exemptions for good cause pursuant to the Rule 9600 Series.[24] The Committee respectfully submits that such transaction-specific exemptive authority is not a practical method for reliably excluding M&A transactions if the Proposed Rule does, indeed, capture such transactions. All such transactions likely would suffer from the same issues noted above. Thus, a categorical exemption for M&A transactions would seem to present a much more workable solution.

We believe that the concept of a "business combination transaction" as defined in Rule 165(f) under the Securities Act would be an appropriate term that could be used in the Proposed Rule to exclude M&A transactions from the scope of the Proposed Rule without having to resort to transaction-specific waiver requests.

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20 Release, p. 16.

21 *Id.*

22 *Id.*

23 *See* Comment Letter of the Committee in Response to the Proposed Amendments (Mar. 14, 2011), p. 7-8.

24 Release, p. 16.

THE PROPOSED RULE SHOULD PERMIT A SINGLE MEMBER TO FILE THE MANDATED DISCLOSURE DOCUMENTS ON BEHALF OF A SELLING GROUP

The Proposed Rule would require each FINRA member that participates in the private placement transaction to make the requisite filing with FINRA.[25] FINRA acknowledges that it considered requiring only one member to file such information. However, it determined that doing so would limit its ability timely to access information about members' private placement activities, and would otherwise complicate the ability of other members to participate, as such members would be required to determine whether other members appropriately satisfied their filing obligations.[26]

The Committee respectfully disagrees with this conclusion. Requiring each member to prepare this information and file it with FINRA introduces unnecessary inefficiencies and redundancies into the private placement process. Rather, FINRA should adopt a private ordering approach in which the parties may, if they choose, contract with one another to designate a lead member to accept filing responsibilities on behalf of the larger group.

A workable model for this approach already exists in the underwritten securities offering context. In connection with such offerings, underwriters typically enter into an agreement among underwriters which establishes the relationship among the underwriting syndicate members, including designating a managing/book-running underwriter with responsibility for distributing the offering documents. We see no reason why FINRA could not extend this concept to the private placement context and permit the "managing" FINRA member to accept filing responsibilities under the Proposed Rule.[27] Since FINRA can prescribe the format in which such information is presented, and the detail to be included, we do not understand why FINRA should have any concern that such joint filings would inhibit its ability timely to access information about the activities of particular members' private placement activities.

THE PROPOSED RULE SHOULD NOT REQUIRE EACH MEMBER OF A SELLING GROUP TO PROVIDE EACH PROSPECTIVE INVESTOR WITH DUPLICATIVE DISCLOSURE DOCUMENTS

Similarly, the Proposed Rule requires that each FINRA member within a selling group provide to each prospective investor a copy of the applicable offering documentation.[28]

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[25] Release, p. 14.

[26] Release, p. 14-15.

[27] We would also propose that any offering document or term sheet identify each selling group member in a manner consistent with Item 508 of Regulation S-K with respect to underwriters so that FINRA would be able to verify the scope of participation by its members.

[28] See Proposed Rule 5123(a)(1) ('no member . . . may offer or sell any securities in [a private placement] . . . unless the member . . . (1) provides a private placement memorandum or term sheet to each investor prior to sale . . .").

This requirement strikes the Committee as being costly, inefficient, and having the potential to inundate investors with duplicative information. We would also expect that FINRA members would be loath to disclose their clients to competitors for purposes of meeting this delivery requirement. In accordance with market practice, we suggest that the Proposed Rule be revised to allow offering document delivery to any given offeree to be effected by the FINRA member that has the relationship with the offeree, but not require all selling group members to cross-deliver to all offerees.

CONCLUSION

In conclusion, the Committee commends FINRA for its consideration of the comments submitted in response to the Rule 5122 Amendment Proposal. While Proposed Rule 5123 represents an improvement over the Rule 5122 Amendment Proposal, the Committee respectfully suggests that the proposal can be improved by implementing the suggestions described above.

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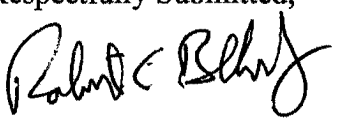
Members of the Committee would be pleased to answer any questions you may have concerning our comments.

Respectfully Submitted,



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