REISA
REAL ESTATE INVESTMENT SECURITIES ASSOCIATION

February 27, 2012

filed via e-mail to rule-comments@sec.gov

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

Re: Release No. 34-66203; File No. SR-FINRA-2011-057

Dear Ms. Murphy:

The Real Estate Investment Securities Association ("REISA")[1] submits this letter in response to the Securities and Exchange Commission's ("SEC") request for comments on Financial Industry Regulatory Authority, Inc.'s ("FINRA") Partial Amendment No. 1 to proposed FINRA Rule 5123 ("Amended Proposed Rule"). We appreciate the opportunity to comment on the Amended Proposed Rule. Our comments will focus on the following issues:

1. Effect on Capital Formation and Competition with Unregistered Firms. FINRA does not believe that the Amended Proposed Rule will "unduly restrict capital formation through the private placement offering process." In addition, FINRA maintains that the filing requirements imposed by the Amended Proposed Rule will be a relatively modest "burden" that is both necessary and appropriate in helping to prevent fraudulent and manipulative acts...to protect investors and the public interest."[2] REISA believes that the additional filing requirements represent more than a modest "burden" on independent broker dealers when considered in light of all the other state and federal securities laws with which they must comply. In addition, REISA believes that the concern over the flight of issuers to unregistered firms to assist distribution efforts is a real consequence and has not been adequately addressed in the Amended Proposed Rule.

2. Available Exemptions. The Amended Proposed Rule exempts certain sales of private placements from the filing requirements imposed on member firms. These exemptions, as currently drafted, are inconsistent with language in existing securities regulations, and clarification is requested.

3. Transparency of Member Information. In the event the Amended Proposed Rule is approved and implemented, REISA believes that summary information solicited by the Amended Proposed Rule should be accessible by all member firms in the interest of transparency.

4. Liability of Broker Dealers. The Amended Proposed Rule does not address the potential penalties or consequences associated with a member firm's failure to timely file the required disclosure documents or notices. REISA believes that information about potential penalties should be included in the language of the Amended Proposed Rule.

These issues are discussed in more detail below.

1: Effect on Capital Formation and Competition with Unregistered Firms.

REISA supports FINRA's efforts to protect the interests of investors, particularly in light of the fraud cases that have plagued the private placement market. However, REISA believes that the problems related to private placements can only partially be solved with additional oversight of member firms by FINRA. In the high profile cases of Medical Capital[3] and Provident Royalties[4], investors were the victims of fraud perpetrated by the issuers of the private placements, rather than the broker dealers distributing the securities. According to the annual report on enforcement actions issued by the North American Securities Administrators Association (NASAA), released in October 2011 for the 12-month period ending December 2010, the majority of fraud cases feature unregistered individuals and firms selling unregistered securities, which includes Regulation D products and other private placements.

One of the ongoing burdens carried by all registered broker dealers is competition from unlicensed and unregistered agents and firms that conduct illicit activities related to capital raising efforts for issuers. These capital raising efforts typically require registration and licensing and should be subject to appropriate levels of oversight and examination by regulators. However, when unregistered firms become involved in capital raising efforts for issuers, registered broker dealers are at a disadvantage. Unregistered firms and agents do not (a) play by the same rules, (b) expend the same resources on compliance, allowing them to compete on costs or (c) protect investors' interests to the same extent as registered firms.

The additional ongoing administrative task of ensuring that disclosure documents are properly filed for the offerings in which a registered broker dealer participates will result in further expense to registered firms, with minimal benefit to investors. As a result of the Amended Proposed Rule, FINRA is expected to receive thousands of filings from member firms. FINRA notes that it will have "trained staff who will be dedicated to analyzing data contained in the notice filings to identify those that contain red flags."[5] FINRA also notes that "[f]or many filings that contain red flags, the department will contact members to make timely inquiries regarding the scope and results of their investigations pursuant to their suitability rule obligations."[6] FINRA will need additional resources to meet these obligations. Since each member firm participating in a private placement is required to make a filing pursuant to the Amended Proposed Rule, this would introduce unprecedented challenges to both FINRA staff and each filing member firm to coordinate the resolution of any red flags, especially in a timely manner. Given FINRA's current challenges in reviewing filings and enforcing investor protection rules, it appears that implementation of the Amended Proposed Rule will only add to FINRA's delays and not provide investors with real time protections. REISA also reiterates its concern with respect to whether FINRA member firms will postpone sales related to such private placements in order to get some "clearance" from FINRA before proceeding with their capital raising efforts. REISA is concerned with this and other potential unintended and indeterminable effects this would have on capital formation, especially in the retail sector, where the predominate amount of capital that is invested through private placements for small businesses is invested by retail investors.

REISA is also concerned that the Amended Proposed Rule will only serve to cause member firms to cease participation in private placements to retail clients due to the additional administrative responsibility and liability, thereby causing issuers to self-distribute or distribute through unregistered firms, further reducing access to capital formation by smaller issuers and small businesses and lessening investor protections. FINRA member firms include approximately 384 large and medium-sized firms[7] and approximately 4,066 small-sized firms. Only a portion of these member firms participate in private placements. The FINRA member firms that comprise the REISA constituency are primarily small firms. REISA members primarily participate in private placement offerings in the $15 million to $50 million range that are sold through the retail marketplace. There are material differences in the type of private placements that are offered through large and medium-sized member firms, and the issuers that offer them, as compared with small member firms. In general, large and medium-sized firms are relatively inactive in offerings by smaller issuers whereas small member firms find themselves relying primarily on small issuer offerings. Small member firms have more limited resources, and any additional burdens placed on them must be balanced against the potential benefit to investors that will be gained. A number of independent broker-dealers, including small firms and former REISA members, have shuttered since 2010 for a variety of reasons, including increasing compliance costs and regulatory burdens that have resulted in shrinking margins.[8] The promulgation of laws under The Dodd-Frank Wall Street Reform and Consumer Protection Act have increased the operating costs of broker-dealers, which is adding to financial pressures on small firms.[9] Additional responsibility must be considered in light of this and all the other regulations with which member firms must comply. The required filing will necessitate an additional level of supervision and recordkeeping to ensure that the proper documents are filed in a timely manner, with potential for additional risk and liability to management personnel at small member firms, thus potentially further reducing small member firm interest in participation in private placements subject to the Amended Proposed Rule.

REISA believes that the potential for illicit activities of unregistered firms are more prevalent with offerings of $50 million or less, as larger transactions would predominantly be out of the reach of these firms. Thus, the activities of such unregistered firms largely compete with and could adversely affect the small firms. REISA believes that the large and medium-sized member firms would be less affected by the private placement activities of unregistered firms or individuals. Consequently, the Amended Proposed Rule will primarily affect capital formation conducted by the small member firms for issuers raising smaller amounts of capital and/or

smaller issuers in general. These small firms cannot typically maintain large compliance departments as they are more limited both in the amount of business they conduct and produce less revenue. Thus, adding more filing and administrative obligations to existing compliance requirements creates more of a personnel and monetary burden without any additional benefit to investors.

2: Available Exemptions.

The Amended Proposed Rule provides exemptions to the filing requirements for offerings sold only to any one or more of the following purchasers:

- institutional accounts, as defined in NASD Rule 3110(c)(4);
- qualified purchasers ("QP"), as defined in Section 2(a)(51)(i)(A) of the Investment Company Act of 1940;
- qualified institutional buyers ("QIB"), as defined in Rule 144A of the Securities Act of 1933;
- investment companies, as defined in Section 3 of the Investment Company Act;
- an entity composed exclusively of qualified institutional buyers ("QIB"), as defined in Securities Act Rule 144A;
- banks, as defined in Section 3(a)(2) of the Securities Act;
- employees and affiliates of the issuer;
- knowledgeable employees, as defined in Investment Company Act;
- eligible contract participants, as defined in Section 3(a)(65) of the Exchange Act; and
- accredited investors described in Securities Act Rule 501(a)(1), (2), (3), or (7).

NASD Rule 3110(c)(4) was replaced by FINRA Rule 4512(c), but FINRA references Rule 3110(c)(4) as well as Rule 144A in the Amended Proposed Rule language regarding exemptions. Rule 4512(c) includes an abbreviated definition of institutional type entities or individuals that varies from existing language in Rule 144A, which defines Qualified Institutional Buyers, and language in Section 2(a)(51)(i)(A), which defines Qualified Purchasers. REISA believes the Amended Proposed Rule should reference the currently applicable FINRA Rule 4512(c) rather than NASD Rule 3110(c)(4).

However, REISA is concerned about the confusion created by FINRA Rule 4512. The current definitions contained in Rule 144A and Section 2(a)(51)(i)(A) provide different guidelines for the establishment of an entity's qualification as either a QIB[10] or QP[11]. The $50 million guideline promulgated by FINRA Rule 4512(c) is a third set of monetary guidelines that varies significantly from Rule 144A and Section 2(a)(51)(i)(A). REISA recommends that FINRA eliminate the $50 million guideline in FINRA Rule 4512(c) because we believe it causes confusion, and that Rule 144A and Section 2(a)(51)(i)(A) adequately define and provide monetary guidance for all institutional type investors. Any existing institutional account should be unaffected by the change in language because the FINRA guideline is set above the Investment Company Act of 1940 guideline and below the Securities Act of 1933 guideline and thus, subject to either Rule 144A or Section 2(a)(51)(i)(A).

3: Transparency of Member Information.

FINRA believes that the Amended Proposed Rule will provide its staff with timely access to information about the private placement activities of FINRA members. Currently, FINRA member firms do not have access to information about the capital formation activities of other member firms. In the event the Amended Proposed Rule is implemented, REISA recommends that summary information collected from the required filings be made available to all member firms through their existing member gateway access. Member firms contemplating participation in a private placement could benefit from member firm access to information collected by FINRA, including:

a. the name of the firms participating in a private placement;
b. the status of such firms' authority to participate in any private placement (i.e., whether the firms can participate in private placements);
c. the status of such firms' participation in any private placement (i.e., whether the firms have sold any of the private placement).

Allowing FINRA members access to this information should not present any significant burden to FINRA, and any burden is offset by the improved transparency among member firms active in the private placement market.

4: Liability of Broker Dealers.

The Amended Proposed Rule does not address any penalties or other consequences associated with a member firm's failure to timely file the required disclosure documents or notices. REISA recommends that FINRA include information about any potential penalties or consequences into the Amended Proposed Rule so member firms understand how FINRA expects to enforce the filing requirements. As currently proposed, the Amended Proposed Rule does not provide member firms with information regarding whether filing penalties will be considered administrative in nature, and therefore, not require disclosure on a firm's disclosure reporting page ("DRP"), or whether penalties will be considered investment related and subject to disclosure reporting. The seriousness of any late filing, incomplete filing, or other non-compliance with filing requirements will have a significant impact on how member firms modify their policies and procedures to ensure compliance.

REISA strongly believes that a member firm's failure to comply with the filing requirements promulgated under the Amended Proposed Rule should be considered administrative in nature and subject to only minor penalties unless a member firm is in repeated violation of the filing requirements (e.g., more than 10% of a member firm's required filings are late or materially incomplete in any 12-month period). In addition, REISA believes that member firms, their principals and compliance officers should not be subject to any monetary fines or disclosure requirements for any first time offenses. REISA also believes that it is important to include certain safe harbors or exemptions into the Amended Proposed Rule. For example, in the event one member firm files a notice of participation on behalf of a group, only the filing member firm should be subject to any penalties related to such filing while the other members of the group should be exempt from any penalties or liability in connection with such filing.

REISA recommends that the following issues be addressed in the final rule regarding the penalties for noncompliance with filing requirements:

a. Will principals or compliance officers of member firms be personally liable, fined or censured in connection with late or no filings?
b. Will failure to comply with filing requirements have any effect on registration exemptions of issuers?
c. How, if at all, will members of a filing group be penalized for the delegated filers non-compliance?

d. Will non-compliance be considered administrative or investment related?
e. What factors will be considered by FINRA in issuing penalties to member firms for non-compliance with filing requirements?

Conclusion

REISA believes in the importance of protecting private placement investors while balancing the need for businesses and issuers of quality investment products to efficiently raise capital without an overly burdensome regulatory scheme. REISA believes, and respectfully requests that FINRA's implementation of the Amended Proposed Rule cannot be at the cost of reducing member firm participation in private placements, which could potentially increase the sales of private placements through unregistered firms and encourage more self-offerings by issuers, which achieves the opposite result that FINRA expects in promulgating the Amended Proposed Rule.

REISA believes that more widespread and extensive enforcement against unregistered firms and individuals would be of greater benefit to investors. However, if the Amended Proposed Rule is implemented, REISA strongly believes that:

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(1) the language regarding exemptions should be amended as described above;
(2) clarification should be included regarding any potential consequences or liability for member firms failing to comply with the filing and disclosure requirements; and
(3) member firms should be provided access (via existing member gateway access) to summary information collected by FINRA through its implementation of the Amended Proposed Rule;
(4) implementation of the Amended Proposed Rule should only occur in conjunction with greater oversight of, and limitations on, an issuer's use of unregistered firms for capital raising activities.

REISA appreciates the opportunity to provide its perspective and comments on the Amended Proposed Rule and looks forward to a continued dialogue with FINRA on these and other important issues for the protection of investors and the capital markets.

Respectfully submitted,

Daniel Oschin
President
Real Estate Investment Securities Association

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[1] REISA is a national trade association that influences over 20,000 real estate securities professionals who offer and manage alternative investments. These alternative investments typically include, but are not limited to non-traded REITs, real estate partnerships, real estate income and development funds, tenant-in-common interests, oil and gas interests, equipment leasing, and other securitized real estate investments. REISA has more than 800 active members, which include broker dealers, sponsors/issuers, Registered Investment Advisers, registered representatives and other alternative investment professionals. REISA works to maintain the integrity and reputation of the industry by promoting the highest ethical standards to its members and provide education, legislative and regulatory advocacy, and networking opportunities. REISA connects members directly to key industry experts providing timely trends and education and helping create a diversified portfolio for their clients.

[2] FINRA Response to Comments, Dated January 19, 2012

[3] SEC v. Medical Capital Holdings, Inc., SEC Litigation Release No. 21141 (July 20, 2009).

[4] SEC v. Provident Royalties, LLC, SEC Litigation Release No. 21118 (July 20, 2009).

[5] FINRA Response to Comments, Page 13, Paragraph 3.

[6] FINRA Response to Comments, Page 13, Paragraph 3.

[7] A medium-sized firm employs more than 151 and no more than 499 registered persons. A large firm employs 500 or more registered persons. A small firms employs at least one and no more than 150 registered persons (FINRA bylaws). As reported by the FINRA Office of Member Relations, as of January 9, 2012, there were 171 large firms, 213 medium firms, and 4,066 small firms, which comprise the 4,450 member firms that FINRA regulates. Not all are active at any given time.

[8] *Independent broker-dealer exits: March 2010-present*. Investment News, February 28, 2011; *B-D with 290 reps to shutter*. Investment News, December 6, 2011. *Will broker-dealer consolidation continue in 2012*. Investment News, December 11, 2011.

[9] *Capital shortage leads WJB to shutter B-D operation*. Investment News, January 8, 1012.

[10] "Qualified purchaser" means---

(A) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under Section 3(c)(7) with that person's qualified purchaser spouse) who owns not less than $5,000,000 in investments, as defined by the commission;

(B) any company that owns not less than $5,000,000 in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefits of such persons;

(C) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a person described in clause (i), (ii), or (iv); or

(D) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25,000,000 in investments.

[11] "Qualified institutional buyer" means:

(i) any of the following entities, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity:

(ii) any insurance company as defined in Section 2(a)(13) of the Act ;

(iii) any investment company registered under the Investment Company Act or any business development company as defined in Section 2(a)(48) of that Act;

(iv) any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;

(v) any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

(vi) any employee benefit plan within the meaning of title I of the Employee Retirement Income Security Act of 1974. ;

(vii) any trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in paragraph (a)(1)(i)(D) or (E) of this section, except trust funds that include as participants individual retirement accounts or H.R. 10 plans.

(viii) any business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;

(ix) any organization described in section 501(c) (3) of the Internal Revenue Code, corporation (other than a bank as defined in Section 3(a)(2) of the Act or a savings and loan association or other institution referenced in Section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, or Massachusetts or similar business trust; and

(x) any investment adviser registered under the Investment Advisers Act.