FINRA
Financial Industry Regulatory Authority

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March 12, 2012

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

Re: File No. SR-FINRA-2011-057 – Rebuttal

Dear Ms. Murphy:

On October 4, 2011, FINRA filed with the Securities and Exchange Commission ("SEC" or "Commission") SR-FINRA-2011-057, a proposed rule change to adopt FINRA Rule 5123 (Private Placements of Securities). The Commission published the proposed rule change for comment in the Federal Register on October 24, 2011.[1] The Commission received 16 comment letters in response to the proposed rule change.[2] On January 19, 2012, FINRA filed Partial Amendment No. 1 to the

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1 See Securities Exchange Act Release No. 65585 (October 18, 2011), 76 FR 65758 (October 24, 2011) (Notice of Filing of SR-FINRA-2011-057).

2 See letters from Ryan Adams, Christine Lazaro, Esq., and Lisa Catalano, Esq., St. John's School of Law Securities Arbitration Clinic, dated November 10, 2011 ("St. John's"); Ryan K. Bakhtiari, President, Public Investors Arbitration Bar Association, dated November 14, 2011 ("PIABA"); David T. Bellaire, Esq., Financial Services Institute, Inc., dated November 14, 2011 ("FSI"); Robert E. Buckholz, Chair, Committee on Securities Regulation, New York City Bar Association, dated November 9, 2011 ("NYC Bar"); Richard B. Chess, President, Real Estate Investment Securities Association, November 14, 2011 ("REISA"); Alicia M. Cooney, Managing Director, Monument Group, dated January 12, 2012 ("Monument"); Martel Day, Chairman, Investment Program Association, dated November 14, 2011 ("IPA"); Jack E. Herstein, President, North American Securities Administrators Association, Inc., dated November 17, 2011 ("NASAA"); Joan Hinchman, Executive Director, National Society of Compliance Professionals, dated November 14, 2011 ("NSCP"); William A. Jacobson, Associate Clinical Professor, and Carolyn L. Nguyen, Cornell Law School, dated November 14, 2011 ("Cornell"); Stuart J. Kaswell, Executive Vice President, Managed Funds Association, dated

proposed rule change and a letter responding to comments (the "Response to Comments").[3] On January 26, 2012, the Commission published in the Federal Register a notice and order to solicit comments on Partial Amendment No. 1 from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether to approve or disapprove the proposed rule change, as modified by Partial Amendment No. 1.[4] The Commission received nine letters in response to the January 26, 2012 notice and order.[5] Three commenters generally supported the proposed rule change, as amended.[6] The remaining commenters raised a number of issues.[7] This letter discusses those comments, describes additional modifications to the proposed rule change, and rebuts any assertion that the proposed rule change, as amended, would not meet the statutory requirements for approval.

November 14, 2011 ("MFA"); William H. Navin, Senior Vice President, The Options Clearing Corporation, dated November 9, 2011 ("OCC"); Jeffrey W. Rubin, Chair, Federal Regulation of Securities Committee, American Bar Association, dated November 14, 2011 ("ABA"); Sullivan & Cromwell LLP, dated November 10, 2011 ("S&C"); Osamu Watanabe, Deputy General Counsel, Moelis & Co., dated November 28, 2011 ("Moelis"); and Donald S. Weiss, K&L Gates LLP, dated November 14, 2011 ("K&L Gates").

3 See letter from Stan Macel, FINRA, to Elizabeth Murphy, Secretary, SEC, dated January 19, 2012; see also Partial Amendment No. 1 to SR-FINRA-2011-057, available on www.finra.org.

4 See Securities Exchange Act Release No. 66203 (January 20, 2012), 77 FR 4065 (January 26, 2012) (Notice of Filing of Partial Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, etc.). The comment period closed on February 27, 2012.

5 See letters from Wesley A. Brown, Managing Director and Chief Compliance Officer, St. Charles Capital, dated February 26, 2012 ("St. Charles"); NYC Bar, dated February 24, 2012; Monument, dated February 27, 2012; William A. Jacobson, Associate Clinical Professor, and Eric Brooks, Cornell, dated February 27, 2012; MFA, dated February 27, 2012; Douglas Martin, dated February 1, 2012 ("Martin"); the Board of Directors of the National Investment Banking Association, dated February 27, 2012 ("NIBA"); Daniel Oschin, President, REISA, dated February 27, 2012; and S&C, dated February 23, 2012.

6 Cornell; NYC Bar; S&C (with one suggested change, discussed supra).

7 Martin; MFA; Monument; NIBA; REISA; St. Charles.

In its notice and order of January 26, 2012, the Commission specifically sought comment regarding four main aspects of the proposed rule change: (1) the categories of offerings subject to the rule; (2) the potential impact on investors purchasing private placement securities through a broker-dealer subject to the rule; (3) the potential impact on members regarding implementation and compliance; and (4) the potential impact on competition and capital formation. The comments are discussed below in relation to these aspects.

Subject Offerings Under the Proposed Definition of Private Placement

The SEC sought comment regarding the categories of offerings that would be subject to the proposed rule change under the proposed definition of "private placement." Some commenters continued to advocate for exemptions for all accredited investors.[8] For the reasons described in the Response to Comments, FINRA disagrees. FINRA believes that the accredited investor standard does not by itself require a sufficiently high level of sophistication to warrant exception from the proposed rule change. As further described in the Response to Comments, FINRA believes that there should be an exemption for some "institutional" accredited investors. FINRA does not believe this exemption should extend, as one commenter advocated, to accredited investors under Rule 501(a)(4), (5) or (6) of Regulation D.[9]

In Partial Amendment No. 1, FINRA proposed changing the reference in the exemption for institutional accounts (paragraph (c)(1)(A) of the rule text) from NASD Rule 3110(c)(4) to new FINRA Rule 4512(c). Two commenters raised concerns about this standard, advocating that it was confusing since it uses a different set of monetary guidelines than those used for Qualified Institutional Buyers (QIBs) in Section 144A of the Securities Act of 1933 and Qualified Purchasers (QPs) in Section 2(a)(51)(A) of the Investment Company Act of 1940.[10] FINRA notes that the proposed rule change, as amended, would exempt offerings sold to all of these categories of purchasers – institutional accounts in FINRA Rule 4512(c), QIBs and QPs. See paragraphs (b)(1)(A), (B) and (C). Participants may qualify for an exemption from the provisions of the Rule based on any of these categories. FINRA does not believe that offering an additional, stand-alone exemption incorporating different criteria is confusing.

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8 Monument, S&C; see also MFA.

9 S&C.

10 NIBA; REISA.

Impact on Investors Purchasing through a Broker-Dealer Subject to the Proposed Rule Change

The SEC sought comment regarding the potential impact on investors purchasing private placement securities through a broker-dealer subject to the proposed rule change. Two commenters expressly noted that the proposed rule change would have a beneficial impact on investors or investor protection.[11] No commenters expressly noted the rule would have a detrimental impact on investors.

Impact on Members Regarding Compliance with the Proposed Rule Change

The SEC sought comment regarding the potential impact on members of having to comply with the proposed rule change, including any burdens associated with implementing the obligations of the proposed rule change. One commenter argued that the Rule should exempt offers of private funds by independent placement agents, based on perceived anticompetitive burdens on such members.[12] FINRA has already addressed this issue in the Response to Comments.

The proposed rule change requires a member to file information about the private placement within 15 calendar days of first sale. One commenter was concerned that the filing could not be made within such time period if a broker-dealer signs a selling agreement more than 15 calendar days after the sale by another member.[13] FINRA notes that the requirement refers to the first sale by the member making the filing (or on whose behalf a designated member is filing), rather than the first sale by another member.

Another commenter raised a concern that the proposed rule change extended to members "participating" in the preparation of a private placement memorandum, term sheet or other disclosure document.[14] However, Partial Amendment No. 1 eliminated this language from the proposed rule text, thus obviating the commenter's concerns.

Potential Impact on Competition and Capital Formation

The SEC asked commenters for input on the potential impact of the proposed rule change on competition and capital formation, including: (a) whether members would continue to participate in private placements subject to the proposed rule change; (b) whether the proposed rule change would encourage issuers to utilize

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11 Cornell; NYC Bar.

12 Monument.

13 Martin.

14 St. Charles.

unregistered firms to effect their covered offerings; and (c) whether the proposed rule change would affect access to capital, the costs of capital raising or the cost of capital for issuers.

Two commenters stated their belief that the proposed rule change would not impose unnecessary burdens on capital formation.[15] Others, however, raised concerns regarding burdens on capital formation. NIBA and REISA argued that the Rule would unduly burden independent broker-dealers and offerings of $50 million or less. Further, NIBA asserted that the Commission should simultaneously introduce (presumably similar) rules that would apply to issuers and entities not regulated by FINRA. FINRA generally supports broader oversight of private placements activity. However, improvement in the protection of customers in the broker-dealer channel should not depend upon whether the Commission engages in rulemaking for issuers and entities outside of that channel.

MFA reiterated its belief, notwithstanding the amendments proposed in Partial Amendment No. 1, that the proposed rule would be fundamentally deficient, repeating the arguments provided in its previous comment letter. As noted in the Response to Comments, FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Securities Exchange Act in that it will provide important investor protections in connection with private placements of securities and is in the public interest.

FINRA is proposing to eliminate the disclosure requirements to more narrowly tailor the proposed rule change. Thus, proposed Rule 5123 would contain only a notice filing requirement. As FINRA noted in the Response to Comments, a requirement to make a notice filing after the offering has commenced and sales have occurred would not impose an unnecessary burden on members or capital formation and would be appropriate in light of the intended regulatory benefits for investors that would flow from enhanced oversight of, among other things, members' compliance with their suitability obligations. Indeed, the filing requirement in the proposed rule change is less burdensome than the current filing requirement in Rule 5122(b)(2), which requires filing of a private placement memorandum no later than when it is provided to a prospective investor.[16]

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15 Cornell; NYC Bar.

16 See, e.g., Securities Exchange Act Release No. 59559 (March 19, 2009), 74 FR 12913 (March 25, 2009) (Order Approving Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to Private Placements of Securities Issued by Members; File No. SR-FINRA-2008-020).

Other Comments

Two commenters suggested that members be provided access to summary information collected by FINRA regarding private placements as a result of the proposed rule change.[17] As FINRA mentioned in the Response to Comments, by the express terms of the proposed rule change this information will be collected solely for regulatory purposes and FINRA intends to provide confidential treatment to all documents and information filed pursuant to it.

These two commenters also sought clarification regarding the liability of members for violations of the Rule.[18] As FINRA stated in the Response to Comments, a wide range of regulatory responses are available for violations of the proposed rule change, as for violations of any FINRA rule. FINRA's regulatory response would depend on the facts and circumstances of the violation in question. FINRA notes that the particular sanction it imposes in each matter is also subject to oversight and review by the Commission.[19]

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FINRA believes that the foregoing responds to the material issues raised by the commenters to this rule filing. If you have any questions, please contact Gary Goldsholle, Vice President and Associate General Counsel, at (202) 728-8104; or me at (202) 728-8056.

Sincerely,

Stan Macel
Assistant General Counsel

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17 NIBA; REISA.

18 NIBA; REISA.

19 See, e.g., Rule 9370 (Application to SEC for Review).