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

June 29, 2012

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-2011-057

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") amendments to proposed Rule 5123 and the SEC's order granting accelerated approval of the proposed rule.[2] The SEC requests comment on its approval of the amended proposed Rule 5123 and whether it is consistent with the Securities Exchange Act of 1934 (the "Exchange Act").

We welcome the amendment to Rule 5123 that would eliminate the requirement that issuers disclose certain information to purchasers of interests in a private fund. The proposed Rule, however, would still impose a new requirement on private funds[3] to file with FINRA a copy of any private placement memorandum ("PPM"), term sheet, or other offering document (and material amendments) used in connection with covered sales within 15 days, or indicate to FINRA that no offering documents were used. For the reasons set out below, amended Rule 5123 would conflict with Section 15A(b)(6), Section 3(f) and Section 19(b)(2) of the Exchange Act.

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[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, North and South America, and all other regions where MFA members are market participants.

[2] Notice of Filing of Amendments No. 2 and No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendments No. 1, No. 2, and No. 3 to Adopt FINRA Rule 5123 (Private Placements of Securities) in the Consolidated FINRA Rulebook, Securities Exchange Act Release No. 67157 (June 7, 2012).

[3] While the Rule applies to FINRA members, it will have a direct and significant effect on private funds.

As explained in our previous letters,[4] Rule 5123 would conflict with the long-standing regulatory framework for private fund offerings. The proposed filing requirement would be 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 Act, and Regulation D, which provides a safe harbor for issuers to comply with Section 4(a)(2). In addition, by requiring a FINRA member that offers or sells private placements to file disclosure materials with FINRA, the Rule would make private offerings more costly and less efficient, thereby imposing an unnecessary burden on capital formation. Accordingly, proposed, Rule 5123 would conflict with Section 15A(b)(6), Section 3(f) and Section 19(b)(2) of the Exchange Act,[5] and we recommend that the SEC disapprove the proposed Rule.

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 would undermine 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 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 terms and conditions. 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 would be inconsistent with Section 4(a)(2), and would undermine the central distinction between public and private offerings.[6]

This conclusion is consistent with the SEC's long-standing position that an issuer conducting a private offering in reliance on Regulation D must only submit to the SEC and applicable state authorities a notice filing on the SEC's 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. 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.

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[4] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (Nov. 14, 2011), available at: https://www.managedfunds.org/wp-content/uploads/2011/11/MFA_Comments_on_FINRA_Rule5123.pdf; Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (Feb. 27, 2012), available at: https://www.managedfunds.org/wp-content/uploads/2012/02/MFA_Comments_on_FINRA_Rule5123_2-27-2012.pdf.

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

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 proposed Rule would promote efficiency, competition, and capital formation. By requiring a FINRA member to file disclosure documents with FINRA, the proposed Rule would make private offerings more costly and less efficient, thereby imposing an unnecessary burden on capital formation. A private fund engaged in an offering would need to identify the type of information required to be filed, and then coordinate with a FINRA member to arrange for submission of the information, leading to a potentially lengthy review process, difficulties in ensuring that appropriate filings were made, and liability concerns. These burdens and delays would inhibit private funds from conducting offerings efficiently and obtaining needed capital to invest throughout the economy.

Requiring private fund managers to file a broad range of documents, including a PPM, term sheet, or other disclosure materials, as well as amendments, would be particularly disruptive and create uncertainty. For example, a manager may provide an investor at various stages of the investment process with one or more term sheets or other documents prior to providing the investor with a complete PPM. As a result, an investor and manager may exchange a series of documents that could be considered disclosure documents. Based on the Rule, it is not clear which type of materials would be considered disclosure documents (*e.g.*, an investor letter), nor is it clear how a manager should make such determination. The Rule would therefore create significant confusion in these situations regarding which materials needed to be filed with FINRA. In addition, it is not clear what policy objective would be served by filing amendments to a term sheet or PPM with FINRA, particularly where such amendments may apply to information unrelated to the type of information FINRA was originally concerned with when it proposed the initial version of the Rule (*i.e.*, use of offering proceeds, amount of offering expenses and compensation).

The Rule would also lead to substantial uncertainty regarding how a broker-dealer would obtain all of the required documents. A broker-dealer that recommends an investment in a private fund and that has not been directly engaged by a fund manager may not continue to be involved in the investment process to a degree that the broker-dealer would obtain all of the relevant disclosure documents provided to the investor. For example, a fund manager would generally provide amendments to a PPM made subsequent to an investment directly to the investor. As a result, the Rule would create uncertainty for both broker-dealers and private fund managers, and would be inconsistent with expectations of market participants.

In our previous letters, we explained that the Rule should be amended to exempt offerings by private funds that rely on exemptions from the definition of "investment company" in Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Investors in hedge funds that rely on either Section 3(c)(1) or Section 3(c)(7) are sophisticated individuals and institutions with the financial wherewithal to understand and evaluate investments in private offerings. These investors typically perform extensive due diligence prior to investing, and obtain detailed information about an offering when making their investment decision.

The amended Rule would not provide an exemption for offerings by Section 3(c)(1) or Section 3(c)(7) funds. Instead, the Rule would include limited exemptions for offerings made to "knowledgeable employees," as defined in Rule 3c-5 under the Investment Company Act, or a new category of investor referred to as "institutional" accredited investors, which would include investors that meet the requirements of Rule 501(a)(1), (2), (3) or (7) of Regulation D. In response to comments that the Rule should exempt offerings to sophisticated investors, including all accredited investors, FINRA stated that it "believes that the criteria used to measure whether a person meets the accredited investor standard do not necessarily reflect a sufficiently high level of sophistication to justify exemption from the proposed rule."

It is unclear upon what basis FINRA would propose to distinguish "institutional" accredited investors from other types of accredited investors. In adopting Regulation D, the SEC determined the thresholds at which institutions and other types of investors qualify as accredited investors, and FINRA's proposal would substitute its judgment for that of the Commission by determining that only certain accredited investors should be exempt under the Rule.

In addition, current FINRA rules already require broker-dealers that sell hedge fund interests to ensure that such investments are suitable, and to provide appropriate disclosure.[7] As a result, including certain types of accredited investors would provide little, if any, benefit because broker-dealers are already subject to specific regulation and oversight in selling hedge fund interests. Furthermore, including individual accredited investors in the Rule will impose significant costs and business risks on private fund managers due to the proprietary nature of the information included in a PPM or other disclosure document. Requiring broad distribution of this sensitive information by private fund managers to multiple FINRA members in connection with sales to individual accredited investors would raise substantial confidentiality and competitive concerns.

The additional exempted investors under the Rule would do little to reduce the burden on capital formation because these exemptions would apply only to certain investors who are eligible to purchase interests in hedge funds, and not to all eligible purchasers. As a result, hedge funds would often be subject to the Rule, and all funds would need to determine whether they are subject to the Rule or able to rely on an exemption on an investor-by-investor basis.[8] In particular, Section 3(c)(1) funds would generally be subject to the Rule because they may sell interests to accredited investors other than the institutional accredited investors described in the proposed Rule. Accordingly, the proposed amendments to the Rule would generally not reduce the compliance burden on funds, and the Rule would impair capital raising by hedge funds in a manner that is inconsistent with Section 3(f) of the Exchange Act.

These burdens would increase the costs of engaging a member of FINRA in connection with a private offering. If the Rule were adopted, a fund manager conducting a private offering would need 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 costs imposed by the Rule would 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-dealers could create uncertainty for issuers and regulators, and would not further the policy objectives of the Rule.

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[7] *See* NASD Notice to Members 03-07 (Feb. 2003).

[8] For example, Section 3(c)(1) funds that sell interests to accredited investors who are natural persons would be subject to the Rule, as would Section 3(c)(7) funds that sell interests to persons that are neither "qualified purchasers" nor "knowledgeable employees," such as certain non-U.S. persons or investors that meet the terms of Rule 3c-5(b) under the Investment Company Act.

For these reasons, we believe amended Rule 5123 would conflict with Section 15A(b)(6), Section 3(f), and Section 19(b)(2) of the Exchange Act. We recommend that the Commission disapprove of Rule 5123, as amended, 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.

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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: Marc Menchel, Executive Vice President and General Counsel for Regulation, FINRA