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Via Electronic Filing

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

RE: File Number SR-FINRA-2011-057; Release Number 34-65585 (Proposed Rule Change to Adopt the New FINRA Rule 5123 on the Private Placements of Securities)

Dear Ms. Murphy:

The Cornell Securities Law Clinic (the "Clinic") welcomes the opportunity to comment on the Proposed Rule Change to Adopt the New Financial Industry Regulatory Authority ("FINRA") Rule 5123 on the Private Placements of Securities ("Proposed Rule"). The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural "Southern Tier" region of upstate New York. For more information, please visit http://securities.lawschool.cornell.edu.

In January 2011, FINRA published a Regulatory Notice seeking a Request for Comment on a proposed amendment to FINRA Rule 5122 ("Regulatory Notice 11-04").[1] Regulatory Notice 11-04 would apply FINRA Rule 5122 disclosure requirements to member firms participating in private placements. On March 14, 2011, the Clinic filed a comment letter in general support of Regulatory Notice 11-04.[2]

After receiving comment letters on Regulatory Notice 11-04, FINRA submitted this Proposed Rule to the Securities and Exchange Commission ("SEC").[3] The Proposed Rule contains the same general disclosure requirements as offered in Regulatory Notice 11-04 though with several

[1] Regulatory Notice: Proposal 11-04, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122787.pdf.
[2] For the text of the Clinic's March 14, 2011 comment letter, please see http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p123348.pdf.
[3] Notice of Filing of Proposed Rule Change To Adopt New FINRA Rule 5123 (Private Placements of Securities), 60 Fed. Reg. 65,758 (Oct. 24, 2011) *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p124886.pdf

changes. Those changes include (1) eliminating the requirement that 85 percent of the proceeds raised must be used for the business purposes as stated in the disclosure document, (2) requiring that member firms file their disclosures fifteen (15) days after the sale, and (3) removing the requirement of disclosing issuer and member affiliation.[4]

The Clinic supports the Proposed Rule for the reasons stated in its previous comment letter and believes that it is an important step in protecting private investors by informing them of the risks involved with private placements. In line with the goals of FINRA Rule 5123, the Clinic offers two suggestions to improve the effectiveness of the Proposed Rule.

I. FINRA Rule 5123 Should Require Issuer and Member Affiliation Disclosures

Regulatory Notice 11-04 would have required issuers and member firms to disclose any affiliation that might exist. FINRA itself noted that "[i]n several recent SEC and FINRA enforcement cases concerning private placements, a participating broker-dealer was affiliated with the issuer, and this affiliation facilitated the broker-dealer's misuse or conversion of offering proceeds."[5] Moreover, private placements transactions tend to be risky; in fact, "[t]he overwhelming majority of financial instruments that turned out to be excessively risky or outright fraudulent were sold through private placements."[6] Given the risks involved with private placements and many recent cases of misconduct rooted in non-disclosure, the need for issuers and members to disclosure their affiliation has become significant. Investors need to know about any potential conflicts of interest between the issuer and the member firms in order to make informed decisions regarding private placements. Therefore, as the Clinic stated in its March 14, 2011 comment letter, the Clinic remains in favor of having an explicit disclosure requirement regarding any affiliation between the issuer and the member firm in the Proposed Rule.

II. Disclosure Exemptions Should Not Apply to Employees and Affiliates of the Issuer

Member firms are exempt from the Proposed Rule's disclosure requirements when dealing with one of seven categories of individuals and entities.[7] While the Proposed Rule provides a statutory definition for nearly every category, the Proposed Rule has left "employees or affiliates of the issuer" undefined. [8] This lack of definition renders the Proposed Rule's exemption overly broad, vague, and detrimental to many investors.

Employees of the issuer include a diverse set of individuals who may or may not need the disclosures put forth in the Proposed Rule. While mid-to-high level employees of the issuers may have a good understanding of the business and thus, be more cognizant of the risks associated with the company, issuing companies also employ individuals who do not have the same level of

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[4] *See* "Text of the Proposed Rule Change" 10-18, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p124598.pdf
[5] *See supra* n1 at 4.
[6] *See* Jill E. Fisch, *The Overstated Promise of Corporate Governance* 77 U. CHI. L. REV. 923, 943 (2010).
[7] *Supra* n5 at 23.
[8] *See id.*

exposure. Employees such as secretaries and other support staff have little to no understanding of the business functions of the company that they work at because they tend to serve the company in a purely administrative capacity. In this scenario, being an employee of the issuer grants little benefit in deciding whether or not to invest in the private placement based on the risks involved. Yet, these individuals are employees of the issuer and would not have to receive the appropriate disclosures. Moreover, applying an existing federal statutory definition of "employee"[9] does not resolve this issue because the definition remains overly broad for the purposes of the Proposed Rule. Therefore, it is necessary for the Proposed Rule to contain a more precise definition of "employee."

Likewise, "affiliate" is vague because the precise scope of the term is unclear. For example, incorporating existing federal statutory definitions of "affiliate" might eliminate ambiguity. SEC Rule 144 defines an "affiliate" of an issuer of securities as "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer."[10] Similarly, Rule 12b–2 of SEC Regulation 12B, which governs the registration and reporting of securities, defines an "affiliate" as a "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified."[11] Thus, we recommend that the Proposed Rule select or define a clear definition of "affiliate."

Conclusion

The Clinic appreciates the opportunity to comment on the Proposed FINRA Rule 5123 and hopes that FINRA will consider some of the concerns raised in this comment letter to further the goals of protecting investors in private placement transactions.

Respectfully submitted,

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[9] 8 C.F.R. § 274a.1(f) states that "[t]he term employee means an individual who provides services or labor for an employer for wages or other remuneration."
[10] 17 C.F.R. § 230.144(a)(1).
[11] *Id.* at § 240.12b–2.