Business Law Section
AMERICAN BAR ASSOCIATION

321 North Clark Street
Chicago, IL 60654
(312) 988-5588
Fax: (312)988-5578
www.ababusinesslaw.org
businesslaw@americanbar.org

November 14, 2011

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Re: File Number SR-FINRA-2011-057
Release No. 34-65585
Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.: Notice of Filing of Proposed Rule Change to Adopt FINRA Rule 5123 (Private Placements of Securities)

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA"), in response to a request for comments in respect of proposed Rule 5123 of the Financial Industry Regulatory Authority, Inc. ("FINRA"), which proposes to establish certain filing and disclosure requirements in respect of certain private placements of securities, pursuant to Securities and Exchange Commission (the "Commission") Release No. 34-65585 dated October 18, 2011 (the "Release").

This letter was prepared by members of the Subcommittee on FINRA Corporate Financing Rules of the Committee (the "FINRA Subcommittee").

The comments expressed in this letter (the "Comment Letter") represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

1. Background.

Pursuant to FINRA Regulatory Notice 11-04, FINRA sought comment on a proposal to amend FINRA Rule 5122 (relating to member private offerings) to, among other things, extend the application of such rule to any private placement of securities in which a member firm or associated person thereof participates.[1]

By letter dated March 14, 2011, the Committee submitted a comment letter to FINRA (the "Prior Comment Letter").[2] The Prior Comment Letter, which was prepared by the FINRA Subcommittee, strongly opposed the proposed expansion of the scope of FINRA Rule 5122 to cover all private placements in which a member firm (or associated person thereof) participates. We reiterate our comments set forth therein.

Following the comment period with respect to FINRA Rule 5122, FINRA determined not to amend FINRA Rule 5122 (and, thus, such rule will continue to be limited to member private offerings). Instead in the Release, FINRA has proposed a new, separate rule – FINRA Rule 5123 – to cover other "private placements" of securities (that is, private placements that do not constitute member private offerings) involving a member firm or associated person thereof, as described below (the "Proposal").

Although FINRA has made a number of helpful revisions to the proposals set forth in Regulatory Notice 11-04, we continue to believe, for the reasons set forth in the Prior Comment Letter, that the Proposal reflects an unwarranted expansion of regulatory authority and oversight by FINRA. If adopted, the Proposal would impose an unnecessary filing requirement on members/associated persons. See Part II(1) and (7) of the Prior Comment Letter.

We request that the Prior Comment Letter be deemed to be submitted as part of our comments with respect to the Proposal. Further, we set forth below our additional comments with respect to the Proposal.

We believe that this letter raises a number of significant concerns regarding the Proposal which, for the reasons set forth below, will result in regulations that would be contrary to the requirements of Securities Exchange Act of 1934 ("Exchange Act"), Sections 3(f) and 15A(6), in that the Proposal:

(1) will not promote just and equitable principles of trade nor enhance the protection of investors and the public interest; and

---

1 http://www.finra.org/Industry/Regulation/Notices/P122788

2 http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p123332.pdf

(2) would impose a significant burden on competition and capital formation by issuers that is not in furtherance of any purposes of the Exchange Act.

2. Definition of "Private Placement."

The Release describes the scope of the Proposal as imposing certain disclosure and filing requirements on a FINRA member and/or associated person who offers or sells "private placements" (and who "participates" in the preparation of "private placement" memoranda, terms sheets or other disclosure documents in connection with "such private placements."). In this regard, the Release states that the "11-04 Proposal" would have extended "virtually all" of the existing requirements of FINRA Rule 5122 to "all private placements in which a member participates (subject to listed exemptions)", but that in response to comments, including the Prior Comment Letter, FINRA elected to leave FINRA Rule 5122 "as is", and to address the proposed expansion of the general requirements of FINRA Rule 5122 through a new, separate rule - FINRA Rule 5123.[3]

FINRA Rule 5122(a)(1) defines the term "member private offering" to mean a "private placement of unregistered securities issued by a member or control entity" and FINRA Rule 5122(a)(4) defines the term "private placement" to mean a "non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act." The concept of a "non-public offering" in the context of the Securities Act of 1933 (the "Securities Act") is well understood to mean a primary offering of securities that is exempt from registration under the Securities Act by reason of Section 4(2) thereof and the rules of the Commission thereunder (including, Rule 506 of Regulation D).[4] In this context, the term non-public offering is to be distinguished from a public offering of securities that would, in the absence of certain other specified exemptions, require Securities Act registration.

In contrast, FINRA Rule 5123(a) would significantly expand the definition of "private placement" to include the "offer or sale [of] any security [by a member or associated person] in reliance on an available exemption from registration under the Securities Act." The scope of the definition would therefore include not only offerings conducted pursuant to Section 4(2) of the Securities Act and the Commission's rules thereunder (as reflected in FINRA Rule 5122), but would also cover many transactions not involving a member private offering, including transactions that do not involve capital-raising. These transactions would include any offer or sale of securities for which an exemption from registration is claimed under the Securities Act, even if such offering is outside the scope of Section 4(2), such as an unregistered public offering (including pursuant to Section 4(5) of the Securities Act and Regulation A thereunder) or if the

---

[3] See Part II.C of the Release under "The 11-04 Proposal."

[4] Section 4(2) of the Securities Act provides an exemption from registration under the Securities Act for "transactions by an issuer not involving any public offering." Rule 506 of Regulation D under the Securities Act provides a non-exclusive safe harbor exemption under Section 4(2) of the Securities Act.

offer/sale involves an unregistered secondary trade or resale transaction. In addition, FINRA Rule 5123 would cover transactions involving a sale of a business structured as a stock sale as well as a merger, transfer of assets, and other business combinations described in Rule 145 under the Securities Act (all generally referred to herein as "M&A Transactions").

For example, Section 3 of the Securities Act sets forth various categories of "exempted securities" and states that the "provisions of this title [i.e., the Securities Act] shall not apply to any of the following classes of securities. FINRA Rule 5123 would apply to offerings of securities issued by banks pursuant to Section 3(a)(2) of the Securities Act. Although FINRA Rule 5123(c)(1)(F) provides an exemption for offerings sold to banks, as defined in Section 3(a)(2) of the Securities Act, there is no exemption for offerings by banks under Section 3(a)(2). Because securities referred to in Section 3(a)(2) are "exempted securities", offerings of such securities would not necessarily be deemed to be private placements (or comply with Section 4(2)) from the perspective of the Securities Act). However, FINRA Rule 5123 would characterize such offerings – perhaps in a misleading/non-standard manner – as a "private placement" simply because these offerings are exempt from registration under the Securities Act.[5]

We view the proposal to deem all offerings not requiring registration under the Securities Act to be "private placements" as inconsistent with established securities law concepts that have been in place for over 80 years. Among other things, the exclusion of Section 3 securities from the scope of the Securities Act was not accidental, but reflects a Congressional determination that public policy considerations were served by removing offers and sales of exempted securities from the scope of the Securities Act. In our view, FINRA should not regulate an area that Congress determined not to regulate, absent clear and convincing evidence that such regulation is consistent with Congressional intent. In addition, we believe that the Commission should not approve such regulation in the absence of such a showing. Deeming any offering of Section 3 securities to be a "private placement", regardless of the manner of offering and the distribution structure, the publicity associated with the offering and the nature of the issuer and the securities involved, is to significantly misrepresent the character of the offering. Imposing a scope of regulation appropriate to non-public offerings on transactions that in many instances may not, in fact, be non-public offerings does not in our judgment represent sound policy.

---

[5] Similarly, offerings of commercial paper that are exempt from registration under the Securities Act by reason of Section 3(a)(3) would be included as "private placements" for the purposes of FINRA Rule 5123, although FINRA Rule 5123(c)(2)(4) would provide an exemption for "offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act." We note as well that the application of FINRA Rule 5123 to certain offerings exempt under Section 3 may create substantive impediments to such offerings. These include the exemptions for exchanges of securities with existing security holders pursuant to Section 3(a)(9), for securities issued following a court or other fairness hearing pursuant to Section 3(a)(10), and for certain intrastate offerings pursuant to Section 3(a)(11).

In addition to its unwarranted expansion to cover Section 3 securities, the definition of "private placement" would appear to encompass any resale of securities through a FINRA member in the secondary market that is exempt from registration under the Securities Act by reason of Sections 4(1), 4(3) or 4(4) under the Securities Act – such as ordinary market transactions, including market making transactions - and would appear to cover repurchase and reverse repurchase (financing) transactions as well as transactions involving security-based swap agreements with sophisticated counterparties (such as, eligible contract participants). Finally, it would also include within its scope transactions that are exempt from registration under the court-recognized, and commonly used, so-called "Section 4(1-1/2)" exemption, dealing with private resales of restricted or control securities. It would not be feasible to mandate the provision of a disclosure document by a FINRA member, or to require a FINRA member to perfect a filing with FINRA, under FINRA Rule 5123 for these types of transactions.

In the Release, FINRA has provided no justification whatsoever for the substantial expansion of the scope of FINRA Rule 5123 beyond a traditional "non-public" primary "offering", as contemplated under FINRA Rule 5122, to include primary and secondary public and private offerings/resales and M&A Transactions. FINRA's stated purpose for the proposed rule, actually found in its discussion of the rule's statutory basis,[6] is as follows:

> FINRA believes that ensuring that investors have information about private placements will provide important *investor protections* in connection with private placements *without unduly restricting capital formation* through the *private placement offering process*. In addition, FINRA believes that the proposed rule change will assist its efforts to identify problematic terms and conditions in private placements, thereby helping to detect and prevent fraud in connection with private placements. (italics supplied).

FINRA has not suggested or offered any historical evidence of "problematic terms and conditions" or frauds in transactions that do not involve capital-raising, such as secondary market trading or M&A Transactions.

We strongly believe that the scope of FINRA Rule 5123 should not extend beyond the scope of FINRA Rule 5122 – limited to non-public primary offerings of securities - and, as noted below, should be construed consistently with the definition of "public offering" in FINRA Rule 5121(f)(11). At the very least, the definition of "private placement" should be scaled down to exclude secondary market transactions that are exempt from registration under the Securities Act by reason of Sections 4(1), 4(3), and 4(4) under the Securities Act, and the rules of the Commission thereunder, as well as Section 4(1-1/2) transactions.

---

[6] See page 8 of the Release, immediately preceding the Commission's summary of FINRA's Statement on the Burden on Competition.

3. FINRA's Burden on Competition Analysis.

FINRA's competitive analysis does not address its basis for applying the rule beyond capital-raising to cover other kinds of transactions. In FINRA's submission to the Commission, it merely states in a conclusory fashion:[7]

> As noted above, the proposed rule change *will not unduly restrict capital formation* through the private placement offering process. The relatively modest "burden" of the proposed rule change is both necessary and appropriate in helping to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. (italics supplied).

FINRA's submission cites no fraudulent or manipulative acts or practices involving transactions that do not involve capital-raising, such as M&A Transactions. Indeed, there are few published reports of misconduct in such transactions. Those transactions typically involve negotiated terms and conditions of the engagement, including the investment banking fees. There is no purpose to be served by requiring a separate disclosure document, to be delivered at a transaction's closing, restating the negotiated terms of the member's engagement. While a business buyer might, in some sense, be considered an "investor," there is no purpose served in delivering to that buyer a disclosure document describing the seller's use of proceeds. Hence, in this context, there is no demonstrable benefit from any burden of FINRA's proposed rule regardless of how "modest" it may be.

Moreover, there are burdens that FINRA has not addressed in this context. While FINRA's rule provides for various exemptions for qualified purchasers, qualified institutional buyers, and institutional accounts, discussed below, FINRA's rule will apply to M&A Transactions involving business buyers and sellers of all sizes. Many small business buyers do not have $25 million of assets, let alone investments, in order to be deemed a "qualified purchaser", and this is the lowest among the qualifying thresholds for a corporate buyer. Some buyers will be natural persons for whom the qualifying threshold is $5 million in investments. In smaller transactions $5 million may be more than the negotiated purchase price.

In these types of transactions, there is typically no private placement memorandum and no term sheet. There may be an "offering book" of information and documents prepared to market the business to prospective buyers, to be coupled with the buyer's own due diligence investigation. There is always a legally binding contract between the parties prescribing the negotiated terms and conditions of the transaction, typically drafted by the parties' legal counsel with little or no involvement by the member. In some of these transactions, the member has been engaged by the business seller and in other transactions the member has been engaged by the business buyer. In either case, the party that engaged the member typically pays the investment banking fees that it negotiated with the member before the transaction began. In

---

[7] See pages 8-9 of SR-2011-057.

either case, the member would bear the cost of preparing and delivering a separate disclosure document to the counter-party in the transaction describing an obvious "use of proceeds" and disclosing the member's compensation, even though the counter-party will not be paying it. There is a legal and administrative cost incurred to develop such a document in each transaction, but no demonstrable purpose served in delivering it to the parties or filing it with FINRA.

In FINRA's submission to the Commission, it summarily dismissed concerns raised by some commenters about applying the proposed rule to M&A Transactions.[8] In response, FINRA said "the proposed Rule provides a method by which a member may apply for an exemption from the provisions of the Rule for good cause pursuant to the Rule 9600 Series." Requiring a member to seek FINRA's waiver on a transaction-by-transaction basis would add yet more legal and administrative burdens on the member and would provide no demonstrable benefit in protecting the parties to the M&A Transaction. This is particularly burdensome to smaller members who routinely handle smaller transactions that would not qualify for the rule's exemptions. We believe there is no reason for FINRA to address these commonly recurring circumstances on a case-by-case basis when the issues could be addressed in the rule itself.

As noted above, whenever the Commission is engaged in the review of a rule of a self-regulatory organization, such as FINRA, Section 3(f) of the Exchange Act requires the Commission to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation and whether the action is necessary or appropriate in the public interest. Similarly, Section 23(a) of the Exchange Act requires the Commission's determination that any burden on competition imposed by a rule is necessary or appropriate in furtherance of the title's purposes. Further, it requires the Commission to identify the reasons for its determination that any burden on competition imposed by such rule is necessary or appropriate in furtherance of the purposes of this title. We believe FINRA has not provided the Commission with a sufficient basis upon which it can make such a determination with respect to this proposed rule, at least in so far as it pertains to transactions that do not involve capital-raising. In light of today's economic environment, we believe the Commission should be particularly concerned, as is Congress, about the impact of federal rulemaking on smaller member firms serving smaller business buyers and sellers.

4. Disclosure Requirements.

FINRA Rule 5123(a)(2) would require a FINRA member (or associated person) which offers or sells a private placement to "prepare a disclosure document" and provide it to "each investor prior to sale" in the case where there is no formal private placement memorandum or term sheet for the private placement. This disclosure document-requirement would apply even if an investor is an "accredited investor", as defined in Rule 501(a) under the Securities Act. In offerings under Rule 506 involving the sales of securities exclusively to accredited investors, the Commission does not prescribe any specific disclosures or require any offering document. As we discussed in detail in the Prior Comment Letter, FINRA is proposing to impose substantive

[8] See SR-2011-057 at page 16, footnote 32.

regulation relating to certain private offerings which go beyond the scope of regulation that Congress has prescribed under the Securities Act, and which also extends beyond the requirements of the Commission.[9] Moreover, if an issuer has not prepared a private placement memorandum or term sheet (where it is not required to do so under Rule 502(b)(1) of the Securities Act, as described above), a FINRA firm may not, practically, be able to obtain the requisite information about the issuer – or have such information confirmed by the issuer. The failure to obtain such information could subject the FINRA member to liability in connection with its obligation to prepare a private placement memorandum or term sheet and lead a member to have to choose between assuming the risk of liability for the preparation of a disclosure document, where the member may not be able to obtain or verify all, or part, of the information required by FINRA to be set forth therein under the Proposal, or refusing a private placement engagement for the issuer. We think that many members would opt for the latter, which may significantly affect the ability of many issuers to raise capital, particularly smaller issuers. In addition, the disclosure required to be made by the member may increase the liability of an issuer for any material misstatement or omission in connection with the offering. Despite efforts to limit the scope of the document, these liability considerations may not only result in significantly more extensive disclosure than would otherwise be required under the Securities Act, but may result in significant added delay to the offering and cost to the issuer.

We recommend that FINRA provide definitions or guidance as to the scope of the terms "sponsor", "finders", and "consultants", as such terms are set forth in FINRA Rule 5123(a)(1). For example, does "consultants" include those contractors whose engagement is related to the offering or its anticipated use of proceeds, or does it cover all contractors then engaged, or anticipated to be engaged, by the issuer?

Finally, we also note that the disclosure (and filing) requirements of FINRA Rule 5123(a) (and (b)) would apply to a "private placement" in which a FINRA member (or associated person) "participates" in the preparation of a private placement memorandum, term sheet or other disclosure document in connection with such private placement. As we discussed in the Prior Comment Letter, we are concerned that the term "participates" will be construed broadly in accordance with the definition of the term "participation" in FINRA Rule 5110(a)(5), which could trigger the application of the rule even if a member is not acting as a placement agent, but merely provides financial advisory/consulting or administrative/ministerial/back-office services to an issuer in connection with a private placement, which services may be described in a private placement memorandum subject to the review of the applicable FINRA member (for example, if an issuer which is a private investment fund sets forth a description of prime brokerage services provided by a member, but where such member does not otherwise act as a placement agent in connection with the offer or sale of the securities issued by such issuer). We, therefore, seek clarification from FINRA that FINRA Rule 5123(a) and (b) would not apply to members that merely provide advisory, consulting or administrative services for an issuer or in connection with

---

[9] We noted as well that because securities offered and sold in Rule 506 offerings are "covered securities", such offerings are also exempt from State regulation pursuant to Section 18 of the Securities Act.

a private placement, but are not otherwise making any offer or executing any sale of securities in respect of such private placement.[10]

5. Filing Requirement.

FINRA Rule 5123(b) would require a FINRA member or associated person who is "participating" in a "private placement" pursuant to FINRA 5123(a) to file a copy of the applicable private placement memorandum, term sheet or other disclosure document, and any exhibits thereto, with FINRA no later than 15 calendar days after the date of the first sale of securities in the applicable offering. Any material amendments to the aforesaid documents would also need to be filed with FINRA no later than 15 calendar days after the date such amendment is provided to any investor or prospective investor by the member.

Pursuant to Section II.C of the Release under "Comments Regarding Filing Requirements", FINRA states that any such filing would constitute a "notice" filing and would "remove any implication that the FINRA staff will provide comments on a filing; that such filing with FINRA could be a precondition to commencing an offering; or that members should expect to receive any FINRA staff input before proceeding with the offering" and that the goal of requiring a filing would be to "provide FINRA staff with timely access to information about the private placement business of FINRA members."

We believe that FINRA should affirmatively state in FINRA Rule 5123(b), or in Supplementary Material thereto, that a filing under FINRA Rule 5123(b) is solely for notice purposes and that the failure to perfect a timely filing does not preclude or otherwise negatively impact the ability of a member, or associated person, to engage in the offer or sale of a "private placement" or participate in the preparation of a private placement memorandum, term sheet or other disclosure document, or any amendment thereto under such rule.

As also noted above, FINRA Rule 5123(b) would require a filing with FINRA of applicable documents by the "participating member or associated person." Pursuant to FINRA Rule 5123(a), as noted above, the disclosure requirement of the Proposal applies if a member or associated person offers or sells any security in a "private placement" or "participates in the preparation" of certain offering documents. As also noted above, we seek clarification from FINRA as to (i) the definition of "participate" or "participation" and whether or not such term is intended to be consistent with FINRA Rule 5110(a)(5) (and if the term is based upon FINRA Rule 5110(a)(5), that FINRA add a cross reference to FINRA Rule 5110(a)(5) in Supplementary Material to FINRA Rule 5123), or is intended to be more limited in scope as discussed above (in which case, FINRA should also so state in Supplementary Material to FINRA Rule 5123), and (ii) whether a member or associated person who does not "participate" in the preparation of a private placement memorandum, term sheet or other disclosure document in connection with a

---

[10] In this regard, we believe that the concept of "participates" should be consistent with the more narrow construction that applies in the context of FINRA Rule 5121. See FINRA Regulatory Notice 09-49 (August 2009).

private placement, but, for example, only acts as a selling agent in connection with the offer and sale of the securities in question pursuant to offering documents that are prepared by parties who are unrelated to the member (such as, the issuer of the securities), is relieved from having to perfect a filing under FINRA Rule 5123(b) on the grounds that such member (or associated person) is not a "participating" member or associated person for these purposes.

FINRA should specify that filings are to be made with the FINRA Corporate Financing Department, as set forth in FINRA Rule 5122(b)(2) (as opposed to filing with "FINRA"), and FINRA should confirm receipt of any filing. FINRA should not require the filing of exhibits that relate solely to the business of the issuer (such as, agreements with third parties), provided such exhibits are identified to FINRA as part of the filing. A member or associated person should not be required to file an amendment to a previous filing unless the amendment relates to the matters required by FINRA Rule 5123(a) to be disclosed.

6. Exemptions.

FINRA Rule 5123(c) sets forth various exemptions from the various requirements of FINRA Rule 5123.

(i) Pursuant to FINRA Rule 5123(c)(11), there is an exemption for "offerings *filed* with FINRA under Rules 2310, 5110, 5121 and 5122." (italics supplied). As noted above, because of the non-standard definition of "private placement", it would appear that an offering of securities by a bank that is exempt from registration under Section 3(a)(2) of the Securities Act would constitute a "private placement" for these purposes, even though such offering would not necessarily be exempt from registration under Section 4(2) (and/or Rule 506) of the Securities Act as a "non-public" offering under the Securities Act. Pursuant to FINRA Rule 5110(b)(9)(F), "securities offered by a bank, savings and loan association, or common carrier" in a "public offering" is required to be filed with FINRA ("must be" filed) under FINRA Rule 5110(b). However, if such an offering is exempt from filing under FINRA Rule 5110(b)(7) (for example, by reason of FINRA Rule 5110(b)(7)(B) if the securities being issued by the bank are non-convertible debt securities or non-convertible preferred securities, in each case, rated by a nationally recognized statistical rating organization in one of its four 4) highest generic rating categories), then although the offering would continue to be subject to the compensation, disclosure and other requirements of FINRA Rule 5110, such offering would not be required to be filed with FINRA under such rule. It would, therefore, appear that such an offering – subject to, but exempt from filing under, FINRA Rule 5110 - would, then, be subject to the requirements of *both* FINRA Rules 5110 and 5123, and a filing would be required under FINRA Rule 5123. We do not believe that this was FINRA's intent, and suggest that FINRA Rule 5123(c)(11) be amended to state that the exemption is for an "offering filed with FINRA under Rule 2310, 5110, 5121 and 5122 *or exempt from filing thereunder in accordance with FINRA Rule 5110(b)(7).*"[11]

[11] We note that pursuant to FINRA Rule 5121(d), certain public offerings that are subject to FINRA Rule 5121(a)(2) are required to be filed with FINRA *under* FINRA Rule 5110. There is, however, no separate filing requirement "under" FINRA Rule 5121. Similarly,

The applicability of FINRA Rules 2310 and 5121, and filings under FINRA Rule 5110, relate solely to offerings which constitute "public offerings", as defined in FINRA Rule 5121(f)(11). Pursuant to such definition, the term "public offering" specifically excludes offerings that are exempt from registration under Sections 4(1), 4(2), or 4(5)[12] of the Securities Act as well as Rules 505 and 506 of Regulation D under the Securities (and Rule 504 of Regulation D, if the securities being offered are "restricted securities" pursuant to Rule 144(a)(3) of the Securities), and offerings exempt from registration pursuant to Rule 144A under the Securities Act. In light of the definition of "public offering" in FINRA Rule 5121(f)(11), we, again, note our belief that the non-standard use of the term "private placement" in FINRA Rule 5123 is confusing and potentially misleading where the term "private placement" would include not only non-public offerings that within the exclusions above, but also certain offerings that would qualify as "public" offerings for the purposes of the Securities Act as well as certain non-public or public secondary/resale trades/transactions.

(ii) FINRA Rule 5123(c)(1)(G) provides for an exemption for offerings to "employees and affiliates of the issuer." We believe that this exemption was intended to state, and should be clarified to cover, "employees *of the issuer or its affiliates*." Because proposed FINRA Rule 5123 does not define "affiliate", we believe that FINRA should either add a definition or provide in Supplementary Material that "affiliate" in FINRA Rule 5123 shall have the meaning ascribed to such term in FINRA Rule 5121(f)(1).

Notwithstanding the foregoing, as we recommended in the Prior Comment Letter, because of ambiguities that could arise in trying to determine, for example, whether or not a investment manager is an "affiliate" of an offshore hedge fund that has an independent board of directors, we would also recommend that there be an exemption for offers and sales to "knowledgeable employees", as defined in Rule 3c-5 under the Investment Company Act of 1940 (the "1940 Act").

(iii) FINRA Rule 5123(c) provides for exemptions in respect of offerings to, among certain other persons, (1) "qualified purchasers", as defined in Section 2(a)(51)(A) of the 1940 Act, (2) "qualified institutional buyers", as defined in Rule 144A under the Securities Act,

---

there is no separate filing under FINRA Rule 2310. As such, FINRA might clarify the exemption in FINRA Rule 5123(c)(11) to state as follows: "offerings filed with FINRA under *FINRA* Rules 5110 and 5122, *including offerings that are subject to FINRA Rules 2310 and* 5121." In addition, FINRA might clarify that the reference to Rule 2310 means FINRA Rule 2310 as opposed to Rule 2310 (suitability) under the former National Association of Securities Dealers, Inc., which is still effective until July 9, 2012.

[12] Section 4(5) of the Securities Act is the former Section 4(6) thereunder; Section 4(6) was redesignated as Section 4(5) under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

and (3) "institutional accounts", as defined in NASD Rule 3110(c)(4).[13] However, many private offerings involve offers/sales to sophisticated institutional investors who qualify as "institutional" accredited investors under Rule 501(a)(1), (2), (3) and/or (7) of Regulation D under the Securities Act, which investors are fully capable of "fending for themselves", but do not meet the much higher monetary thresholds to fit within (1), (2) and/or (3) of this subsection (iii). As such, we recommend that FINRA adopt a separate exemption for offers and sales to such institutional accredited investors.

(iv) As noted above, FINRA Rule 5123 could cover private placements involving security-based swap agreements, which are now deemed to be "securities" under the Securities Act and the Exchange Act. Such swaps are generally limited to purchase/sale by "eligible contract participants", as defined in Section 3(a)(65) of the Exchange Act ("ECPs"). Accordingly, we suggest that FINRA exclude such security-based swap agreements, as well as sales to ECPs, from the requirements of FINRA Rule 5123.[14]

(v) If FINRA does not modify the definition of "private placement" in FINRA Rule 5123, as suggested above, FINRA should provide exemptions in FINRA Rule 5123(c) in respect of secondary market transactions that are exempt from registration under the Securities Act by reason of Sections 4(1), 4(3), and 4(4) under the Securities Act and the Section 4(1-1/2) exemption, as well as M&A Transactions.

(vi) FINRA Rule 5123(c) should provide for an exemption for offers and sales of standardized options made pursuant to Rule 238 under the Securities Act. Rule 238 exempts from registration any standardized option that is issued by a clearing agency registered under Section 17A of the Exchange Act and that is traded on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act. Because standardized options are exchange-traded and must be cleared by a registered clearing agency, they lack many of the characteristics of "private placements" as contemplated in the Proposal.[15] FINRA Rule 5123(c) should also provide an exemption for cleared over-the-counter options, provided that such options are offered and sold exclusively to ECPs. Again, ECPs are very sophisticated investors similar to

---

[13] We note that FINRA has proposed to move NASD Rule 3110(c)(4) into new FINRA Rule 4512(c). See FINRA Regulatory Notice 08-25 and Commission Release No. 63181 (October 26, 2010).

[14] We note that pursuant to FINRA Rule 0180(b), none of the FINRA Rule 5100 Series currently applies to members' activities and positions with respect to security-based swap agreements.

[15] Standardized options are also subject to the disclosure regime established by the Commission pursuant to Rule 9b-1 under the Securities Exchange Act of 1934. All investors and prospective investors in standardized options are required to receive a copy of a document entitled "Characteristics & Risks of Standardized Options", also know as the options disclosure document or "ODD."

"qualified purchasers."[16] As FINRA Rule 5123(c) already provides an exemption for offers and sales to qualified purchasers, we believe that an exemption for offers and sales to ECPs is also appropriate.

* * *

[16] For natural persons, to qualify as an ECP such person must have more than $10,000,000 invested on a discretionary basis.

The Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with FINRA and/or the Commission and their respective staffs, and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
Jeffrey W. Rubin, Chair
Federal Regulation of Securities Committee

Drafting Committee:
David M. Katz
Dana G. Fleischman
Shane B. Hansen
Mark Lab
Peter W. LaVigne
Suzanne Rothwell
Jeffrey W. Rubin