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U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Kevin M. O'Neill, Deputy Secretary

Re: File Number SR-FINRA-2013-026; SEC Release No. 34-69843
Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc. Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Members' Filing Obligations under FINRA Rule 5123 (Private Placements of Securities)

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee ("Committee") of the Business Law Section ("Section") of the American Bar Association ("ABA"), in response to a request for comment from the Securities and Exchange Commission ("Commission") set forth in Commission Release No. 34-69843 (June 25, 2013)("Commission Release"). The Commission Release solicited comment on proposed rule changes (collectively, the "Amendment") filed with the Commission on June 20, 2013, by the Financial Industry Regulatory Authority, Inc. ("FINRA"). FINRA designated the Amendment, which relates to member firms' filing obligations in connection with certain private placements under FINRA Rule 5123, as "non-controversial" within the meaning of Rule 19b-4(f)(6) under the Securities Exchange Act of 1934 ("Exchange Act"), making the Amendment effective immediately upon filing with the Commission.[1]

The comments expressed in this letter, which were prepared with the assistance of the Committee's Subcommittee on FINRA Corporate Financing Rules, represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors. Accordingly, these comments do not represent the official position of either the ABA or the Section.

[1] Pursuant to the Commission Release, the Commission waived the usual 30-day operative delay, thus making the Amendment operative upon the date of filing with the Commission, and also invited interested persons to submit comments on whether, among other things, the Commission should temporarily suspend the Amendment at any time within 60 days of FINRA's filing of the Amendment "if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the [Exchange] Act."

Summary

We believe that the new "diligence-related" questions added to the electronic filing form ("Private Placement Form" or "PPF") by the Amendment[2] raise important issues involving the role and responsibilities of member firms acting as placement agents in private placements that are not otherwise exempt from Rule 5123. These issues include whether responding to the new questions will impose additional substantive obligations on member firms, the relative costs and benefits of responding to such questions, the legal and liability consequences of certain responses by member firms (including but not limited to "unknown"), and the potential adverse competitive impact on member firms.

We appreciate that FINRA has undertaken a review of private offerings in which member firms are participating as placement agents in an effort to protect investors, identify abusive sale practices and reduce the number of fraudulent or disadvantageous offerings, but respectfully submit that the new requirement to respond to substantive questions should be subject to further regulatory review and consideration in light of public comment. For this reason, and as further discussed below, we urge the Commission to suspend the Amendment on a temporary basis until the Commission has had an opportunity to review and consider all comments elicited in response to the Commission Release. We also include in this letter some suggestions for clarification of the new diligence-related questions to better facilitate compliance by member firms.

Discussion

In general, we support the use of electronic forms by FINRA – such forms make it easier for members to submit information to FINRA, and for FINRA to review and analyze the information it receives. When FINRA makes changes to electronic forms, however, it often does so in order to facilitate compliance with an existing rule – for example, changes made to the electronic form used by firms acting as underwriters to file under Rule 5110 (the Corporate Financing Rule). The requests for information in the Rule 5110 form are intended, for the most part, to reflect the requirements of Rule 5110, as well as related Rules 2310 (Direct Participation Programs) and 5121 (Public Offerings of Securities with Conflicts of Interest), and as such do not add to or otherwise change the substantive requirements of those rules. Rule 5123, on the other hand, does not by its terms require disclosure of specific types of information, other than a copy of the applicable offering document or a statement that no offering document is being used. In our view, the addition of new questions to the Private Placement Form that implicate the

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[2] As outlined in the Commission Release (at p. 4), these questions are: (a) "whether the offering is a contingency offering"; (b) "whether independently audited financial statements are available for the issuer's most recent completed fiscal year"; (c) "whether the issuer is able to use the offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer's affiliates; (d) whether the issuer has a board of directors comprised of a majority of independent directors or a general partner that is unaffiliated with the firm"; (e) "whether the issuer has engaged, or does the member anticipate that the issuer will engage, in a general solicitation in connection with the offering or sale of the securities"; and (g) "whether the issuer, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer's affiliates has been the subject of SEC, FINRA or state disciplinary actions or proceedings or criminal complaints within the last 10 years".

nature and scope of members' diligence duties in non-exempt private placements constitutes the equivalent of an amendment to the Rule warranting public notice and opportunity for comment.

FINRA's position that the new questions on the electronic form do not impose more than a "very modest burden upon filing members" is predicated on the fact that the form permits filers to respond "unknown" to the new questions. However, providing the option to answer "unknown" is not the same as providing the option to decline to answer (as is possible, for example, in response to Item 5 of Form D). Depending upon the meaning of the word "unknown" as used in the PPF, ascertaining whether information is, in fact, unknown could be burdensome in itself. In this connection, we note that there is no discussion -- either in FINRA's rule filing or the Commission Release -- of what level of investigation, if any, is required or expected of a member firm in responding to the new questions,[3] nor when knowledge of potentially responsive information on the part of any employee, associate or affiliate of a member firm reasonably can or should be imputed to the regulated person – the firm itself.

Member firms often deal with this knowledge issue, both within and outside the firm, by preparing and circulating questionnaires, as in connection with FINRA Rules 5110, 5121, 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and 5131 (New Issue Allocations and Distributions). Preparation and circulation of such questionnaires, and analyzing the responses, can result in significant costs in the form of employee time and related expenses (including, but not necessarily limited to, fees of outside counsel). Indeed, the questionnaires used to comply with Rules 5130 and 5131 also impose substantial costs on non-members – collective fund managers and others who, in order to respond to questionnaires they receive, routinely obtain questionnaires from their own investors.

We believe in any event that member firms will be reluctant to respond "unknown" to some or all of the new questions, since to do so may suggest that the firm has not conducted adequate due diligence relating to a specific transaction. The PPF does not indicate what level and type of diligence is necessary in this context. Thus, a practical effect of the new PPF may well be to set a baseline of expected knowledge and dictate areas in which placement agents may have to perform additional substantive due diligence. How much due diligence members should do, and in what areas, and how this obligation compares with members' existing due diligence obligations (as discussed in FINRA Regulatory Notice 10-22) are important issues that warrant public comment and a careful cost/benefit analysis in light of such comment.

Following the effectiveness of new Rule 506(c) of Regulation D under the Securities Act of 1933 ("Securities Act"), issuers will be able to use general solicitation and general advertising in connection with private placements, provided they sell securities solely to accredited investors and take the requisite "reasonable steps to verify" the accredited investor status of all purchasers. Issuers therefore will have several options not previously available in traditional Rule 506 (now Rule 506(b)) and Securities Act Section 4(a)(2) private offerings. To illustrate, both reporting and non-reporting issuers alike will be able (subject only to the new "bad actor" disqualification provisions codified in Rule 506(d)) to: offer and sell exclusively on-

[3] Compare Rule 506(d)(2)(iv)(establishing a "reasonable care" exception to the new Regulation D "bad actor" disqualification provisions).

line or by means of other media involving general solicitation/advertising; use an online platform not registered as a broker-dealer as permitted by Section 4(b) of the Securities Act and dispense with a placement agent entirely; or sell online using a FINRA member firm to effect transactions. As a general proposition, we believe that issuers already prefer that their private offering materials not be filed with FINRA, and the further disclosures called for by the new PPF may cause some issuers to determine not to engage a member firm to participate in the offer and sale of their securities in an unregistered exempt offering. We believe this raises further questions that should be addressed. First, will the potential loss of private placement business place additional competitive burdens on member firms at a time when they also may be coping with competitive pressure caused by Rule 506(c)? Second, will the additional disincentives to issuer use of member firms as placement agents reduce the intermediation of registered broker-dealers and, with that, the benefits to investors of, among other things, the performance of suitability determinations required by FINRA Rule 2111?[4]

Comments on Specific Questions Added to the PFF by the Amendment

The Committee has the following comments on the terms and questions used in the Rule 5123 form which, assuming the new diligence-related questions are added to the PPF, would clarify those questions and therefore facilitate compliance by member firms:

1. *Unknown.* Because the term "unknown" is not defined in the Amendment, it is difficult for member firms to determine the nature and scope of diligence measures required to comply with their new disclosure obligations. It may be helpful in this context to consider the last question – whether the issuer or any officer, director, executive management or affiliate of the issuer, among others, has been the subject of certain disciplinary actions, proceedings or criminal complaints in the last 10 years. This single question could require significantly broader and more costly inquiries to be made by a member firm. How far must a firm go in an effort to identify all covered persons before it may respond with an "unknown", particularly if the issuer is a private company and does not otherwise make available information on the identities of all of its "affiliates"? How will a member firm be expected to identify all "affiliates" in the absence of a definition of the term – will firms be expected to apply the Commission's open-ended definition in Securities Act Rule 405? Does a member firm have an affirmative obligation to query an issuer directly absent publicly available information before it may respond with "unknown"?

   Difficult questions of imputed knowledge also are raised by use of the term "unknown", as previously mentioned. To illustrate just a few: If several member firms are participating in a private placement, must a fact known to one firm, such as the disciplinary history of an affiliate of the issuer, be imputed to all participating firms, so

[4] We understand that issuers may benefit from their ability under Rule 506(c) to rely on a registered broker-dealer's efforts in satisfying the new "reasonable steps to verify" requirement; however, the Commission also has made clear that licensed attorneys, CPAs and registered investment advisors may be used for this purpose. Moreover, as discussed above in the text, issuers that wish to conduct online offerings are free to do so via electronic platforms that will not have to register as brokers or dealers under conditions specified in new Section 4(b) of the Securities Act.

that an answer of "unknown" by one of the other firms would be deemed false? Focusing solely on a single member firm, what if a member has many offices, registered representatives and employees within or outside the United States; in such circumstances, should a fact known to one be deemed to be known by the entire organization? What if an employee is aware of a person's (or entity's) disciplinary history, but does not know that this person (or entity) is an affiliate of the issuer?

Assuming the choice of "unknown" is retained, we suggest that a narrow interpretation be issued that would focus on the relevant "knowledge" group -- the deal team of the member tasked with filing the PPF. We believe that filers should be able to treat facts that are not actually known to the members of the deal team at the time that the form is filed as "unknown".

2. *Is the Form D filing information available?* If FINRA is asking whether the issuer has filed a Form D with the Commission which is publicly available on the Commission's EDGAR web site, we suggest that the question be rephrased accordingly to avoid confusion. We further suggest that FINRA make clear that an affirmative response to this question will not be deemed to indicate that the contents of the Form D are true and complete, or that a timely filing has been made.

3. *Is this a contingency offering?* To avoid confusion, we recommend that this question be revised to specify that what is being referred to is an offering subject to Exchange Act Rule 15c2-4(b).

4. *Is the issuer able to use offering proceeds to make or repay loans to, or purchase assets from, any officer, director or executive management of the issuer, sponsor, general partner, manager, advisor or any of the issuer's affiliates?* Because the question does not indicate what is meant by the phrase "able to use," further clarification is needed. As currently phrased, it is unclear whether the term is intended to refer to the issuer's ability under state or federal law, the laws of its governing jurisdiction, the provisions of its organizational documents, its contracts and agreements with third parties, or pursuant to its offering materials (or some combination of the foregoing). We believe that this question would elicit more useful information if it were reformulated to ask whether any written offering materials (if any) disclose that proceeds are currently intended to be used for such a purpose.

5. *Does the issuer have a board of directors comprised of a majority of independent directors or a general partner that is unaffiliated with the firm?* Only stock exchange listed companies are required in most cases to have a board of directors composed of a majority of independent directors. As there would be few private companies that would meet this requirement (setting aside for discussion purposes any applicable state corporate or other laws), we do not believe that a negative response would be meaningful for purposes of a risk analysis of the offering and, as such, would not provide an investor protection benefit.

Absent a specific definition of independence to be applied in responding to the question, we believe that the question is unduly vague and ambiguous. Any response necessarily would be arbitrary and potentially meaningless in the case of non-listed, non-reporting companies that are not otherwise subject to "independence" definitions in listing standards, Commission rules (such as Exchange Act Rules 10A-3 and 16b-3), or governing corporate or partnership law. Here, at least, it would appear that the burdens potentially imposed on both member firms and issuers would outweigh any concomitant investor protection benefit.

6. *Has the issuer [or any of certain designated persons] been the subject of SEC, FINRA, or state disciplinary actions or proceedings or criminal complaints within the last 10 years?* The Commission recently adopted an amendment to Rule 506 barring the use of the Rule 506(b) and 506(c) exemptive safe harbors if the issuer or certain other persons have been subject to disciplinary events of the type listed in new paragraph (d) of that rule occurring after the effective date of the amendment. An offering involving persons with such disciplinary histories that pre-date the effective date of Rule 506(d) must be accompanied by specific disclosures prescribed by new Rule 506(e). The disciplinary events and persons identified in the new question differ from those in Rule 506(d). The required request for information in the amended PPF is, potentially, significantly broader in both the scope of the triggering events as well as the scope of the covered persons under Rule 506(d). For example,

    a. Rule 506(d) limits the scope of covered persons to executive officers (that is, officers with policy-making responsibilities) and only "officers" who are "participating in the offer." The new question does not appear to be so limited.

    b. It is not clear what is contemplated by the term "advisor" to the issuer in the context of the PPF – does it refer only to financial advisors, or to non-financial advisors as well?

    c. The new question uses the undefined term "sponsor", while Rule 506(d) uses the term "promoter" (as defined in Rule 405). Do they mean the same thing?

    d. The triggering events – "disciplinary actions or proceedings or criminal complaints" -- could exceed the scope (and, in certain situations the disqualification period) of Commission Rule 506(d), and not necessarily be limited to investment-related matters. For example, the use of the term "criminal complaint" could be seen to include any unprosecuted complaint, not necessarily one resulting in a conviction or plea of nolo contendere, and could encompass misdemeanors or minor traffic violations. In order to reduce the burden on member firms, it would be far better for member firms and issuers to apply the same disqualification criteria in private placements, at least in the absence of any compelling reason to require different information. In our view, the amended PPF should simply ask whether the offering is (or would be, if it were a Rule 506 offering) subject to "bad actor" disqualification under Rule 506(d) or the disclosure requirements of Rule 506(e).

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

Very truly yours,

Catherine T. Dixon

Catherine T. Dixon, Chair
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