SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59599; File No. SR-FINRA-2008-020)

March 19, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to Private Placements of Securities Issued by Members

I. Introduction

The Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("Commission" or "SEC") on September 11, 2008, and amended on January 7, 2009,[1] pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")[2] and Rule 19b-4 thereunder,[3] a proposal to adopt new FINRA Rule 5122 ("Rule") which would prohibit FINRA members or associated persons from offering or selling any security in a "Member Private Offerings" unless certain conditions have been met. This proposal was published for comment in the Federal Register on January 26, 2009.[4] The Commission received two comments on the proposal.[5] This order approves this proposed rule change.

---

1 Amendment No. 2 to SR-FINRA-2008-020. This amendment replaced and superseded the original filing submitted to the SEC on September 11, 2008. Amendment No. 1, which was filed on December 22, 2008, was withdrawn on January 7, 2009.

2 15 U.S.C. 78s(b)(1).

3 17 CFR 240.19b-4.

4 Exchange Act Release No. 59262 (January 16, 2009), 74 FR 4487 (January 26, 2009) (SR-FINRA-2008-020).

5 See letter from Neville Golvala for ChoiceTrade dated February 17, 2009 ("2009 ChoiceTrade letter") and letter from Jack L. Hollander for the Investment Program Association ("IPA") dated February 17, 2009 ("IPA letter").

II. Description of the Proposed Rule Change

FINRA proposed to adopt new FINRA Rule 5122, which would require a member that engages in a private placement of unregistered securities issued by the member or a control entity to (1) disclose to investors in a private placement memorandum, term sheet or other offering document the intended use of offering proceeds and the offering expenses, (2) file such offering document with FINRA, and (3) commit that at least 85 percent of the offering proceeds will be used for business purposes, which shall not include offering costs, discounts, commissions and any other cash or non-cash sales incentives.

A. Background

FINRA proposed the Rule in response to problems identified in connection with private placements by members of their own securities or those of a control entity (referred to as "Member Private Offerings" or "MPOs"). In recent years, FINRA has investigated and brought numerous enforcement cases concerning abuses in connection with MPOs.[6] Among the allegations in these cases were that members failed to provide written offering documents to

---

[6] Franklin Ross, Inc., NASD No. E072004001501 (settled April 2006), summarized in NASD Notice Disciplinary Actions, p. 1 (May 2006); Capital Growth Financial, LLC, NASD No. E072003099001 (settled February 2006), summarized in NASD Notice Disciplinary Actions, p. 1 (April 2006); Craig & Associates, NASD No. E3B2003026801 (settled August 2005), summarized in NASD Notice Disciplinary Actions, p. D6 (October 2005); Online Brokerage Services, Inc., NASD No. C8A050021 (settled March 2005), summarized in NASD Notice Disciplinary Actions, p. D5 (May 2005); IAR Securities/Legend Merchant Group, NASD No. C10030058 (settled July 2004), summarized in NASD Notice Disciplinary Actions, p. D1 (July 2004); Shelman Securities Corp., NASD No. C06030013 (settled December 2003), summarized in NASD Notice Disciplinary Actions, p. D1 (February 2004); Neil Brooks, NASD No. C06030009 (settled June 2003), summarized in NASD Press Release, NASD Files Three Enforcement Actions for Fraudulent Hedge Fund Offerings (August 18, 2003); Dep't of Enforcement v. L.H. Ross & Co., Inc., Complaint No. CAF040056 (Hearing Panel decision January 15, 2005); Dep't of Enforcement v. Win Capital Corp., Complaint No. CLI030013 (Hearing Panel decision August 6, 2004). In addition to these cases, FINRA has numerous ongoing investigations involving MPOs.

investors or provided offering documents that contained misleading, incorrect, or selective disclosure, such as omissions and misrepresentations regarding selling compensation and the use of offering proceeds. In addition, as part of its examination program, FINRA conducted a non-public sweep of firms that had engaged in MPOs and found widespread problems. The MPO sweep revealed that in some cases, offering proceeds were used for individual bonuses, sales contest awards, commissions in excess of 20 percent, or other undisclosed compensation.

Because MPOs are private placements, they are not subject to existing FINRA rules governing underwriting terms and arrangements and conflicts of interest by members in public offerings.[7] This proposed rule change is intended to provide investor protections for MPOs that are similar to the protections provided by NASD Rule 2720 for public offerings by members.[8]

In response to concerns about MPOs, FINRA issued Notice to Members 07-27 ("NTM 07-27") in June 2007 to solicit comment on a proposed new rule regarding MPOs (then numbered proposed NASD Rule 2721). FINRA received sixteen comment letters in response to NTM 07-27.[9] These comments were varied. Some of these commenters expressed support for

---

7 FINRA Rule 5110 and NASD Rules 2720 and 2810 govern member participation in public offerings of securities.

8 Members would remain subject to other FINRA rules that govern a member's participation in the offer and sale of a security, including FINRA Rules 2010 and 2020 and NASD Rule 2310. Members also are subject to the anti-fraud provisions of the federal securities laws, including Sections 10(b), 11, 12 and 17 of the Exchange Act.

9 The following is a list of persons and entities submitting comment letters in response to NTM 07-27: Letter from Timothy P. Selby for Alston & Bird LLP dated July 20, 2007 ("Alston & Bird letter"), letter from Keith F. Higgins for American Bar Association ("ABA") Committee on Federal Regulation of Securities dated July 20, 2007 ("ABA letter"), letter from Todd Anders dated July 13, 2007 ("Anders letter"), letter from Neville Golvala for ChoiceTrade dated July 19, 2007 ("2007 ChoiceTrade letter"), letter from Stephen E. Roth, et al of Sutherland, Asbill & Brennan, LLP for the Committee of Annuity Insurers ("CAI") dated July 20, 2007 ("CAI letter"), letter from Peter J Chepucavage for the International Association of Small Broker-Dealers and Advisors ("IASBDA") dated July 20, 2007 ("IASBDA letter"), letter from Alan Z. Engel for LEC

the intent of the proposed rule but voiced concerns about its breadth and scope,[10] while others questioned the benefit or necessity of the proposed rule.[11] Most of these comment letters also suggested edits to the proposed rule.[12] These comments received in response to NTM 07-27, and changes to the Rule as proposed as compared to the rule as it appeared in NTM 07-27, are described in more detail below in Sections II.B through II.F.

B. Definitions

The proposed rule change states that no member or associated person may offer or sell any security in a MPO unless certain conditions are met. The proposed rule change defines a MPO as "a private placement of unregistered securities issued by a member or control entity." The proposed rule further defines two of the terms in the definition of MPO, "private placement"

Investment Corp. dated June 14, 2007 ("LEC letter"), letter from Daniel T. McHugh for Lombard Securities Inc. dated July 20, 2007 ("Lombard letter"), letter from Dexter M. Johnson for Mallon & Johnson, P.C. dated July 19, 2007 ("Mallon & Johnson letter"), letter from John G. Gaine for Managed Funds Association ("MFA") dated July 20, 2007 ("MFA letter"), letter from Curtis N. Sorrells for MGL Consulting Corp. dated July 20, 2007 ("MGL letter"), letter from Thomas W. Sexton for the National Futures Association ("NFA") dated July 20, 2007 ("NFA letter"), letter from Michael S. Sackheim and David A. Form for the New York City Bar Committee of Futures and Derivatives Regulation dated July 10, 2007 ("NYC Bar letter"), letter from Joseph A. Fillip, Jr. for PFG Distribution Co. dated July 19, 2007 ("PFG letter"), letter from Mary Kuan for Securities Industry and Financial Markets Association ("SIFMA") dated July 27, 2007 ("SIFMA letter"), and letter from Bill Keisler for Stephens Inc. dated July 20, 2007 ("Stephens letter").

10 See MFA letter, CAI letter, and Alston & Bird letter.

11 See Anders letter, Mallon & Johnson letter, 2007 ChoiceTrade letter, ABA letter, and SIFMA letter. FINRA did not agree with SIFMA that the potential for abuses in connection with private offerings by non-members is a reason to abandon the proposed rule change. The FINRA staff believed that offerings by members raise unique conflicts that require the protections of the proposed rule change. FINRA also disagreed with SIFMA's contention that they do not have legal authority to adopt the proposed rule change.

12 See Alston & Bird letter, ABA letter, LEC letter, Mallon & Johnson letter, MFA letter, MGL letter, PFG letter, and SIFMA letter.

and "control entity." In response to one comment received in response to NTM 07-27,[13] FINRA defined the term "private placement" to be "a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act [of 1933]."

The proposed rule change defines the term "control entity" as "any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons." The term "control" is defined as "a beneficial interest, as defined in Rule 5130(i)(1), of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership or other non-corporate legal entity."[14] The power to direct the management or policies of a corporation or partnership alone (e.g., a general partner), absent meeting the majority ownership or right to the majority of profits, would not constitute "control" as defined in proposed FINRA Rule 5122. For purposes of this definition, FINRA clarified that entities may calculate the percentage of control using a "flow through" concept, by looking through ownership levels to calculate the total percentage of control. For example, if broker-dealer ABC owns 50 percent of corporation DEF that in turn holds a 60 percent interest in corporation GHI, and ABC is engaged in a private offering of GHI, ABC would have a 30 percent interest in GHI (50 percent of 60 percent), and thus GHI would not be considered a control entity under this definition.

FINRA also reaffirmed, as stated in NTM 07-27, that performance and management fees earned by a general partner would not be included in the determination of partnership profit or loss percentages. However, if such performance and management fees are subsequently re-

---

13 See ABA letter and SIFMA letter.

14 FINRA added language regarding "other non-corporate legal entities" based on commenters' suggestions to clarify that control would extend to entities other than corporations or partnerships. See ABA letter and SIFMA letter.

invested in the partnership, thereby increasing the general partner's ownership interest, then such interests would be considered in determining whether the partnership is a control entity.

In response to several comments received in response to NTM 07-27 advocating that the timing for determining control take place at the conclusion rather than the commencement of an offering,[15] FINRA revised the definition of control to be determined immediately after the closing of an offering. The definition also clarifies that, in the case of multiple closings, control will be determined immediately after each closing. If an offering is intended to raise sufficient funds such that the member would not control the entity under the control standard, but fails to raise sufficient funds, the member must promptly come into compliance with the Rule, including providing the required disclosures to investors and filings with FINRA's Corporate Financing Department ("Department").

C. Disclosure Requirements

The proposed rule change would require that a member provide a written offering document to each prospective investor in an MPO, whether accredited or not, and that the offering document disclose the intended use of offering proceeds as well as offering expenses and selling compensation.[16] If the offering has a private placement memorandum or term sheet, then such memorandum or term sheet must be provided to each prospective investor and must contain these disclosures. If the offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that discloses the intended use

---

15 See Alston & Bird letter, ABA letter, LEC letter, MFA letter, MGL letter, NYC Bar letter, and SIFMA letter.

16 Given that FINRA is not imposing limits on selling compensation as it does in other rules, they did not believe it was necessary to provide a detailed definition of "selling compensation" as urged by SIFMA. FINRA believed that the term "selling compensation" for purposes of a disclosure requirement is sufficiently clear.

of offering proceeds as well as offering expenses and selling compensation. FINRA clarified that the Rule is not meant to require a particular form of disclosure, however. To emphasize this point, FINRA proposed to issue Supplemental Material 5122.01, which would note that nothing in the Rule shall require a member to prepare a private placement memorandum that meets the additional requirements of Rule 502 under the Securities Act of 1933 ("Securities Act").

FINRA believed that every investor in an MPO should receive basic information concerning the offering. FINRA also believed that none of the disclosures required in the proposed rule change would conflict with requirements under federal or state securities laws.[17]

In response to comments received in response to NTM 07-27,[18] the proposed rule change eliminates the previously proposed requirements to disclose risk factors and "any other information necessary to ensure that required information is not misleading." One commenter at the time was concerned that requiring disclosure of these items could lead to an inconsistent scheme of regulation in interpreting the application of the federal securities laws to private placements if FINRA's expectation of what should be disclosed differed from the expectations of the SEC and the courts.[19] While FINRA omitted these disclosures from the proposed rule change, they specifically requested comment on their decision to exclude such disclosures.[20]

D. Filing Requirements

The proposed rule change would require that a member file a private placement memorandum, term sheet or other offering document with the Department at or prior to the first time such document is provided to any prospective investor. Any amendments or exhibits to the

---

17 See SIFMA letter.

18 See ABA letter.

19 See ABA letter.

20 Exchange Act Release No. 59262 (January 16, 2009), 74 FR 4487 (January 26, 2009).

offering document also must be filed by the member with the Department within ten days of being provided to any investor or prospective investor. The filing requirement is intended to allow the Department to identify those offering documents that are deficient "on their face" from the other requirements of the proposed rule change. Notably, the filing requirement in the proposed rule change differs from that in Rule 5110 (Corporate Financing Rule) in that the Department would not review the offering and issue a "no-objections" letter before a member may commence the offering.

FINRA affirmed, in response to concerns raised in comment letters received in response to NTM 07-27,[21] that information filed with the Department pursuant to proposed FINRA Rule 5122 would be subject to confidential treatment. FINRA included a provision in the proposed rule change explicitly clarifying this position.[22] FINRA has stated that the Department plans to develop a web-based filing system that would allow for the filing to be deemed filed upon submission.[23] In addition, the proposed rule change would not impose any additional requirements regarding filing of advertisements or sales materials, which would continue to be governed by NASD Rule 2210.[24]

---

21 See ABA letter, Mallon & Johnson letter, and SIFMA letter.

22 See proposed 5122(d). This confidential treatment provision is similar to that provided in FINRA Rule 5110(b)(3).

23 As noted supra, and in NTM 07-27, neither FINRA nor the Department would issue a "no objections opinion" regarding any offering document filed with the Department. However, FINRA has stated that if it subsequently determined that disclosures in the offering document appeared to be incomplete, inaccurate or misleading, they could make further inquiries. The filing requirement also could facilitate the creation of a confidential Department database on MPO activity that would be used in connection with the member examination process.

24 See NYC Bar letter and SIFMA letter.

One commenter responding to NTM 07-27 suggested that a member's filing of Form D pursuant to Securities Act Regulation D should provide sufficient information to FINRA.[25] FINRA staff disagreed. For example, FINRA noted that the information in Form D does not include information on a wide variety of expenses or applications of proceeds, nor does Form D require that such information is contained in the offering documents.

E. Use of Offering Proceeds

Proposed Rule 5122(b)(3) would require that each time an MPO is closed at least 85 percent of the offering proceeds raised be used for business purposes, which would not include offering costs, discounts, commissions, or any other cash or non-cash sales incentives. The use of offering proceeds also must be consistent with the disclosures to investors, as described above. This requirement was created to address the abuses where members or control entities used substantial amounts of offering proceeds for selling compensation and related party benefits, rather than business purposes. The proposed rule change does not limit the total amount of underwriting compensation. Rather, under the proposed rule change, offering and other expenses of the MPO could exceed a value greater than 15 percent of the offering proceeds, but no more than 15 percent of the money raised from investors in the private placement could be used to pay these expenses. FINRA noted that the 15 percent figure is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 and the North American Securities Administrators Association guidelines with respect to public offerings subject to state regulation.

---

[25] See Mallon & Johnson letter.

Some commenters responding to NTM 07-27 expressed concern that the 85 percent limit was arbitrary or unnecessary,[26] and should be reduced or eliminated to allow flexibility for management in MPOs.[27] FINRA believed that when a member engages in a private placement of its own securities or those of a control entity, investors should be assured that, at a minimum, 85 percent of the proceeds of the offering are dedicated to business purposes. FINRA recognized that changing the business purpose or use of proceeds in an offering may in some instances benefit investors and reminded members that the member may change its use of proceeds, provided it makes appropriate disclosure to investors and files the amended offering document with the Department.

One commenter responding to NTM 07-27 requested that, when an issuer plans a series of MPOs, the issuer should be allowed to calculate the 85 percent limit at the end of the series.[28] FINRA believed, however, that the limit should apply to each MPO in order to assure investors that at least 85 percent of each offering in a series is dedicated to the business purposes described in that offering's offering document. As a result, FINRA clarified that the 85 percent limit applies to each MPO.

---

26 See IASBDA letter, Mallon & Johnson letter, ABA letter, and SIFMA letter.

27 See IASBDA letter, Mallon & Johnson letter, and ABA letter.

28 See NYC Bar letter.

F. Proposed Exemptions

Proposed Rule 5122 would include a number of exemptions for sales to institutional purchasers because FINRA's findings did not reveal abuse vis-à-vis such purchasers, who are generally sophisticated and able to conduct appropriate due diligence prior to making an investment. Specifically, the proposed Rule would exempt MPOs sold solely to the following:

- Institutional accounts, as defined in NASD Rule 3110(c)(4);
- Qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;
- Qualified institutional buyers, as defined in Securities Act Rule 144A;
- Investment companies, as defined in Section 3 of the Investment Company Act;
- An entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A; and
- Banks, as defined in Section 3(a)(2) of the Securities Act.

In addition, the proposed rule change excludes the following types of offerings, which do not raise the concerns identified in the sweep or enforcement actions:

- Offerings of exempted securities, as defined by Section 3(a)(12) of the Exchange Act;
- Offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;
- Offerings in which a member acts primarily in a wholesaling capacity (i.e., it intends, as evidenced by a selling agreement, to sell through its affiliate broker-dealers, less than 20% of the securities in the offering);
- Offerings of exempted securities with short term maturities under Section 3(a)(3) of the Securities Act;
- Offerings of subordinated loans under Exchange Act Rule 15c3-1, Appendix D;[29]

[29] Members' offerings of subordinated loans are subject to an alternative disclosure regime. In 2002, the SEC approved a rule change to require, as part of a subordination agreement, the execution of a Subordination Agreement Investor Disclosure Document. See Exchange Act Release No. 45954 (May 17, 2002), 67 FR 36281 (May 23, 2002); see also Notice to Members 02-32 (June 2002).

- Offerings of "variable contracts," as defined in NASD Rule 2820(b)(2);
- Offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referred to in FINRA Rule 5110(b)(8)(E);
- Offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(5) of the Commodity Exchange Act;
- Offerings of equity and credit derivatives, including over-the-counter ("OTC") options, provided that the derivative is not based principally on the member or any of its control entities; and
- Offerings filed with the Department under FINRA Rule 5110 or NASD Rules 2720 or 2810.

Finally, the proposed rule change also would exempt MPOs in which investors would be expected to have access to sufficient information about the issuer and its securities in addition to the information provided by the member conducting the MPO. These exemptions include:

- Offerings of unregistered investment grade rated debt and preferred securities;
- Offerings to employees and affiliates of the issuer or its control entities; and
- Offerings of securities issued in conversions, stock splits and restructuring transactions executed by an already existing investor without the need for additional consideration or investments on the part of the investor.

This list of exemptions is largely based on the exemptions previously proposed in NTM 07-27, with a few additions and clarifications in response to comments.[30] FINRA clarified that exempted securities, as defined by Section 3(a)(12) of the Exchange Act, would not be subject to the Rule.[31] In addition, FINRA proposed an exemption for commodity pools in view of the

---

30 See Lombard letter, ABA letter, MGL letter, NYC Bar letter, MFA letter, NFA letter, Alston & Bird letter, Anders letter, PFG letter, CAI letter, 2007 ChoiceTrade letter, Mallon & Johnson letter, and SIFMA letter.

31 Accordingly, FINRA noted that in connection with this proposed Rule, they do not plan to recommend amending NASD Rule 0116 or the List of NASD Conduct Rules and Interpretive Materials that apply to Exempted Securities. See CAI letter.

oversight and regulation performed by the NFA and the Commodity Futures Trading Commission.[32] FINRA also clarified that variable contracts and other life insurance products would be excluded,[33] because the offer and sale of these types of offerings are already subject to existing FINRA rules.[34] FINRA also proposed an exemption for member private offerings that are filed with the Department under FINRA Rule 5110 or NASD Rules 2720 or 2810.

In addition, FINRA clarified aspects of other previously proposed exemptions. FINRA clarified that their intent regarding the exemption for wholesalers is to provide an exemption for those that do not primarily engage in direct selling to investors.[35] FINRA also clarified that offerings of securities issued in conversions, stock splits, and restructuring transactions that are executed by an already-existing investor without the need for additional consideration or investment on the part of the investor would be exempt.[36]

FINRA also noted that equity and credit derivatives, such as OTC options, would be exempt, provided that the derivative is not based principally on the member or any of its control entities.[37] As a technical matter, the issuer of an equity or credit derivative is the member firm, and thus would make such offering an MPO. However, where the security offered is not based principally on the member or any of its control entities (e.g., an OTC option on Microsoft Corporation), FINRA does not believe such sale should be subject to the provisions of the

---

32 See NYC Bar letter, MFA letter, NFA letter, Alston & Bird letter, and SIFMA letter.

33 See CAI letter and PFG letter.

34 See, e.g., NASD Rule 2820.

35 See MGL letter and SIFMA letter.

36 See Mallon & Johnson letter.

37 See SIFMA letter.

proposed rule change. On the other hand, if the derivative is based principally on the member or a control entity (e.g., an OTC option overlying the member), then the sale of such security should be treated as an MPO and subject to the requirements of the proposed rule change.

Finally, FINRA clarified that the exemption for employees and affiliates of issuers would apply to employees and affiliates of control entities as well, because these persons are expected to have access to a level of information about the securities of the issuer similar to employees and affiliates of the issuer itself.[38]

Based on the comment letters received in response to NTM 07-27,[39] FINRA also reconsidered whether offerings to accredited investors should be exempt. However, FINRA continued to believe that an exemption for offerings made to accredited investors would not be in the public interest due to the generally low thresholds for meeting the definition of the term "accredited investor." FINRA noted that the SEC has recently proposed clarifying and modernizing its "accredited investor" standard.[40]

Additionally, FINRA believed that financial products offered by a public reporting company,[41] an investment fund,[42] or a state or federal bank affiliate of a FINRA member,[43] should not be excluded based solely on their status as a reporting company, a fund, or a bank. FINRA's belief was that, as a general matter, exemptions are best tailored based on the type of

---

38 See Stephens letter; see also Lombard letter.

39 See 2007 ChoiceTrade letter, PFG letter, and SIFMA letter.

40 See, e.g., Securities Act Release No. 8828 (Aug. 3, 2007), 72 FR 45116 (Aug. 10, 2007); Securities Act Release No. 8766 (Dec. 27, 2006), 72 FR 400 (Jan. 4, 2007).

41 See ABA letter and SIFMA letter.

42 See MFA letter.

43 See Anders letter and ABA letter.

securities offered or the type (and sophistication) of the purchaser rather than the type of offeror. FINRA also declined to exempt offerings that contribute below a specified level of a member's net worth (e.g., 5 %), to create a categorical exemption for all exempted securities under Section 3(a) of the Securities Act, or to expand the exemption for securities with short term maturities under Section 3(a)(3) of the Securities Act to include all securities with a maturity of nine months or less.[44] As a practical matter, however, many of these products would be exempt because they meet one of the other exemptions enumerated in the Rule.

III. Comment Letters

The Commission received two comment letters in response to the proposed rule change.[45] The Commission also received FINRA's response to comments.[46] One letter voiced serious objections to the Rule,[47] while the other raised issues relating to the scope of the Rule.[48] The specific comments from these two letters, as well as FINRA's response to these comments, are discussed in detail below.

One commenter stated that FINRA did not have jurisdiction to adopt the Rule.[49] FINRA found no basis in this allegation because they believe that the Rule is consistent with Section 15A(b)(6) of the Exchange Act and that the proposed rule change will provide important investor protections. FINRA also points out that the Rule, by its terms, would apply to members and their associated persons in connection with the offer and sale of a specific type of security offering.

---

44 See SIFMA letter.

45 Supra note 5.

46 Letter from Stan Macel, FINRA, dated March 9, 2009.

47 2009 ChoiceTrade Letter.

48 IPA Letter.

49 2009 ChoiceTrade Letter.

Both commenters argued that the requirements of the proposed rule change as applied to control entities of a member are overly broad. One commenter argued that the Rule would affect private placements by control entities that are not members which should not be part of the proposal.[50] The other commenter argued that FINRA did not have jurisdiction over control entities that are not broker-dealers.[51] FINRA disagreed with the commenters, stating that it has narrowly tailored the Rule to apply only in those instances where it believes oversight is warranted. For example, the definition of "control" in the Rule was limited to situations where the member owns more than 50% of the shares or distributable profits of the entity, where control has been found elsewhere at as little as 10%. Further, FINRA asserts that the Rule is designed to address conflicts attendant to private offerings by the member and its control entities. FINRA does not believe that this conflict is any less relevant when the capital is not being raised directly for the member's business purpose.

One commenter argued that FINRA should issue no-objection letters or otherwise demarcate the end of their review process.[52] FINRA responded that the purpose of their review is to find filings that are deficient on their face, and thus does not intend to engage in an extended review as it does in other situations. FINRA did note that the filed documents may be utilized in the member examination process.

Both commenters raised objections to the imposition of a limit on offering expenses. FINRA disagrees with the commenters and believes that the limits placed on members in the

---

50 IPA letter.

51 2009 ChoiceTrade letter. See also supra for FINRA's response to the jurisdictional question.

52 IPA letter.

Rule are warranted based on the abuses FINRA has found. They believe that investors should be assured that in the case where members are placing their own or a control entity's securities. They also point out that some limits are already in place via other rules or guidelines.

NTM 07-27 required additional disclosures beyond what was proposed by FINRA to the Commission, but FINRA requested specific comment as to whether those additional disclosures should be put back into the Rule.[53] Only one commenter addressed this question, but did support FINRA's decision to remove these additional disclosures.[54]

One commenter objected to limiting the requirement of filing the offering document with FINRA to FINRA members only.[55] FINRA responded that private offerings by members raise unique conflicts that necessitate the Rule. Further, that there is potential for abuse in private offerings by non-members is not a rationale for abandoning the proposal.

One commenter challenged FINRA's ability to keep the documents submitted to them confidential in spite of the promise of confidential treatment in proposed Rule 5122(d).[56] FINRA strongly disagreed with this assessment. This commenter also argued that there were insufficient occurrences of disconcerting behavior by members to warrant a rule, asserted that the Rule required a private placement memorandum and objected to a new requirement to do so, argued that the anti-fraud rules were sufficient to address the behavior FINRA was concerned with, objected to the filing requirement generally, objected to making the offering document

---

53 Exchange Act Release No. 59262 (January 16, 2009), 74 FR 4487 (January 26, 2009). See also supra Section II.C.

54 IPA letter.

55 2009 ChoiceTrade letter.

56 Id.

available for the member examination process, argued that accredited investors should be excepted from the Rule, and argued that the Rule was an over-reaction to the findings cited by FINRA in the proposal.[57]

IV. Discussion and Findings

After careful review of the proposed rule change, the comments, and FINRA's response to the comments, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.[58] In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[59] which requires, among other things, that FINRA rules be designed 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. The Commission believes that FINRA is seeking to protect investors and the public interest as a result of numerous findings of disconcerting behavior by its members in connection with MPOs. The Commission also believes that FINRA has tailored the Rule to prohibit members or associated persons from offering or selling securities in certain MPOs in order to ensure that investors are protected from such abusive conduct with minimal disruption on capital formation. The Commission notes that, as explained in the supplementary material to the Rule, nothing in the Rule shall require a member to prepare a private placement memorandum that meets the additional requirements of Securities Act Rule 502.

---

57 Id.

58 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

59 15 U.S.C. 78o-3(b)(6).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[60] that the proposed rule change (File No. SR-FINRA-2008-020), as modified by Amendment No. 2, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[61]

Florence E. Harmon
Deputy Secretary

---

60 15 U.S.C. 78s(b)(2).

61 17 CFR 200.30-3(a)(12).