FINRA
Financial Industry Regulatory Authority

Stan Macel
Assistant General Counsel

Direct: (202) 728-8056
Fax: (202) 728-8264

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

Re: File No. SR-FINRA-2008-020 – Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing, a proposed rule change to adopt new FINRA Rule 5122 (Private Placements of Securities Issued by Members) ("Rule"). The Commission received two comment letters in response to the proposal.[1]

The proposed rule change 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.

Most of the issues in the IPA and ChoiceTrade comment letters were previously raised by commenters to FINRA's Notice to Members 07-27 and addressed in the rule filing. However, to create a complete record, we address each of the issues raised by the commenters below.

Both IPA and ChoiceTrade argue that the requirements in the proposed rule change as applied to control entities of a member are overbroad. We disagree. As defined in the Rule, a "control entity" of a member is an entity in which a member has

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[1] Letter from Neville Golvala, CEO, ChoiceTrade, to Florence Harmon, Deputy Secretary, SEC, dated February 17, 2009 ("ChoiceTrade"); letter from Jack L. Hollander, Chairman, IPA Executive Committee, to Elizabeth M. Murphy, Secretary, SEC, dated February 17, 2009 ("IPA").

a beneficial interest 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. This is a very high threshold and control is often established at levels far below 50 percent.[2] Furthermore, the Rule provides that the power to direct the management or policies of a corporation or partnership alone would not constitute "control." In addition, entities may calculate the percentage of control using a "flow through" concept, as described more fully in the rule filing. This provision ensures that entities that are effectively controlled by members are subject to the requirements of the Rule. Finally, the Rule proposes several exemptions. In these ways FINRA has endeavored to narrowly tailor the Rule to apply only in those instances in which we believe regulatory oversight is warranted.

As part of its argument that the Rule is overbroad, IPA raises concerns that it may extend to offerings by owners or control persons of a member that are seeking to raise capital for purposes unrelated to the member. FINRA staff does not believe that the application of the rule should depend on whether the capital raised is directly for the member's business purposes. Rather, the rule is intended to address the conflicts attendant to private offerings by the member and its control entities. The conflicts the rule is designed to address are not mitigated by the fact that the business of a control affiliate is unrelated to that of the member. In addition, FINRA staff believes that if the business of the control entity afforded a basis for exclusion from the proposed rule, it would undermine the effectiveness of the proposed rule as firms could redirect their capital raising activities to such control entities in an effort to avoid the Rule.

ChoiceTrade expresses concern that the Rule does not extend to non-FINRA members. As noted in the filing, we believe that offerings by members raise unique conflicts that require the protections of the proposed rule change. The fact that some believe there is potential for abuse in connection with private offerings by non-members is not a rationale for abandoning the proposed rule change.[3]

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2 See, e.g., NASD Rule 2720(b)(1) (which presumes control at a level of 10 percent of beneficial ownership).

3 We find no basis in ChoiceTrade's challenge to FINRA's jurisdiction regarding these activities of members and their control entities. As noted in the rule filing, FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Securities Exchange Act, which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will provide important investor protections in connection with private placements of securities by members and control entities. By its terms, it would apply to members and their associated persons in connection with the offer and sale of a specific type of securities, member private offerings, as defined in the Rule. In sum, the

ChoiceTrade also challenges the efficacy of the Rule's provision to ensure confidential treatment for information provided to FINRA staff, stating that the provision "affords no practical protection to members." We strongly disagree. The explicit language in Rule 5122(d), which is substantially similar to that provided in FINRA's corporate financing rule (Rule 5110(b)(3)), ensures confidential treatment for information provided to FINRA.

IPA advocates that FINRA should issue "no-objection" letters to members wishing to participate in member private offerings, or in the alternative, be required to submit inquiries to members regarding proposed member private offerings within a prescribed period of time (e.g., within 10 calendar days). As described in the proposed rule change, the filing process is intended to alert FINRA staff of potential problems from filings that are deficient "on their face." FINRA does not intend to undertake a comprehensive, pre-offering review as it does with respect to the public offerings under Rule 5110 (Corporate Financing Rule). The filings will facilitate the creation of a confidential database that could be used in connection with the member examination process.

FINRA staff also is not persuaded by IPA and ChoiceTrade's objections that the proposed limitations on use of offering expenses are unwarranted. As noted in the rule filing, this requirement was created to address the abuses in which members or control entities used substantial amounts of offering proceeds for selling compensation and related party benefits, rather than business purposes. FINRA believes 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 the business purposes disclosed in the offering document. Thus, we believe this limit is warranted and note that it is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 (Direct Participation Programs), and the North American Securities Administrators Association ("NASAA") guidelines with respect to public offerings subject to state regulation.

Finally, we do not agree with ChoiceTrade's recommendation to provide an exception for member private offerings to accredited investors. As discussed in the rule filing, we continue 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."

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proposed rule change does not exceed FINRA's jurisdiction as the basis for the Rule's application is the offer or sale of a security by a member or an associated person.

FINRA believes that the foregoing responds to the material issues raised by the commenters to this rule filing. If you have any questions, please contact Gary Goldsholle, Vice President and Associate General Counsel, at (202) 728-8104; or me at (202) 728-8056.

Very truly yours,

Stan Macel
Assistant General Counsel