FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS
www.financialservices.org

VIA ELECTRONIC MAIL

March 15, 2011

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 11-04 – Private Placement of Securities

Dear Ms. Asquith:

On January 11, 2011, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 11-04 (RN 11-04) requesting comment on a proposal to amend FINRA Rule 5122 related to the private placement of securities (Proposed Amendments).[1] The Proposed Amendments would require, subject to certain exemptions, disclosure in the offering document of the intended use of offering proceeds, expenses, and the amount of selling compensation to be paid to the broker-dealer and its associated persons, in any private placement in which a participating broker-dealer (or its control entity) is the issuer. Moreover, the Proposed Amendments would require that at least 85 percent of the offering proceeds be used for the business purposes identified in the offering document and would require each offering document to be submitted to FINRA.

The Financial Services Institute (FSI)[2] welcomes this opportunity to comment on the Proposed Amendments. We generally support the Proposed Amendments and believe that they will bring an enhanced level of disclosure to investors in private placements. However, we believe that the Proposed Amendment's bright line rule related to the use of offering proceeds should be altered to create a disclosure-based directive. Additionally, we believe that the responsibility of filing the offering document with FINRA should rest with the Managing Broker-Dealer of a private placement. These concerns are addressed in more detail below.

Background on FSI Members

FSI represents independent broker-dealers (IBD) and the independent financial advisors that affiliate with them. The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their

[1] See FINRA Regulatory Notice 11-04, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122787.pdf.

[2] The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind – FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI's mission is to create a healthier regulatory environment for their members through aggressive and effective advocacy, education and public awareness. FSI represents more than 125 independent broker-dealers and more than 16,000 independent financial advisors, reaching more than 15 million households. FSI is headquartered in Atlanta, GA with an office in Washington, D.C.

unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.[3] These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[4] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Rule

As stated above, FSI generally supports the Proposed Amendments and believes that they will bring an enhanced level of disclosure to investors in private placements. However, we believe that the Proposed Amendment's bright line rule related to the use of offering proceeds should be altered to create a disclosure-based directive. Additionally, we believe that the responsibility of filing the offering document with FINRA should rest with the Managing Broker-Dealer of a private placement. These concerns are address in more detail below.

- **Use of Offering Proceeds** – The Proposed Amendment to FINRA Rule 5122(b)(3) related to the use of the offing proceeds, and provide that:

> For each [Member Private Offering] private placement, at least 85% of the offering proceeds raised [must] may not be used [for business purposes, which shall not include] to pay for offering costs, discounts, commissions, [or any other cash or non-cash sales incentives] and any other compensation to participating broker-dealers or associated persons, and must be used for the business purposes required to be disclosed by

[3] Cerulli Associates at http://www.cerulli.com/.
[4] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

> paragraph (b)(1)(A)(i). [The use of the offering proceeds also must be consistent with the disclosures required in paragraph (b)(1)]"

As proposed, any and all private placements that involve a FINRA member firm would be prohibited from using more that 15% of the offering proceeds to pay for, among other things, legal fees, organizational fees, actual costs, and other expenses related to the private placement. We believe that this bright line limitation on the use of funds (85/15) is anti-competitive in nature and could possibly hinder the ability for smaller offerings to raise capital via FINRA member firms. Moreover, this bright line limitation may push issuers to explore alternative means of raising capital without the assistance of FINRA member firms in an effort to avoid the proposed 85/15 limitations.

FSI believes that FINRA should eliminate the 'one size fits all' approach that is laid out in the Proposed Amendments and should replace it with a disclosure-based directive. FSI supports an effective broker-dealer disclosure regime. We believe that investors can make wise choices when they are informed through effective disclosure. As a result, FSI urges FINRA to develop an effective disclosure that will address how fees and expenses related to a private placement are paid, rather than creating a bright line threshold of fees and expenses that can be paid related to the private placement.

- **Filing Requirement** – The Proposed Amendments to FINRA Rule 5122(b)(2) relate to the obligations of filing the offering document(s) with FINRA, and provide that:

> [A member must file t] The private placement memorandum, term sheet or such other offering document must be filed with the Corporate Financing Department at or prior to the first time the document is provided to any prospective investor. Any amendment[(s)] or exhibit[(s)] to the private placement memorandum, term sheet or other offering document also must be filed with the Department within ten days of being provided to any investor or prospective investor.

As currently written, it is not clear which member in the selling group is obligated to file the private placement memorandum, term sheet, or such other offering document with FINRA. As such, every FINRA member who participates in the sale and distribution of a private placement would have to file the same document(s) with FINRA to comply with this provision of the Proposed Amendments. In an effort to clarify roles and responsibilities and to eliminate redundancies in the process, FSI urges FINRA to require the Managing Broker-Dealer of the private placement to file the private placement memorandum, term sheet, or such other offering document with FINRA. We suggest that FINRA use the following language in FINRA Rule 5122(b)(2):

> The Managing Broker–Dealer of the private placement must file with the Corporate Financing Department the private placement memorandum, term sheet or such other offering document at or prior to the first time the

document is provided to any prospective investor. Any amendment[(s)] or exhibit[(s)] to the private placement memorandum, term sheet or other offering document also must be filed by the Managing Broker-Dealer with the Department within ten days of being provided to any investor or prospective investor.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to on the Proposed Amendemnts to FINRA Rule 5122.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

Dale E. Brown, CAE
President & CEO