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Re: Regulatory Notice 25-06: Request for Comment on Modernizing FINRA Rules, Guidance and Processes to Facilitate Capital Formation

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1700 K Street, N.W.
Washington, D.C. 20006

Ladies and Gentlemen:

We strongly commend FINRA's efforts to modernize its rules, simplify compliance and codify additional exceptions from the requirements of the rules governing public offerings. We support the significant steps FINRA has proposed to promote and reduce burdens on capital formation.

We are writing because we believe that modifications to FINRA Proposed Rule 5121(a)(1)(A)(ii)c are needed to better achieve FINRA's goals of simplifying compliance and to level the playing field among different issuers subject to Rule 5121.

Background of Rule 5121 and the Proposal Currently, under Rule 5121(a), if a FINRA member has a conflict of interest with respect to a public offering of securities, a qualified independent underwriter (a "QIU") is required to conduct due diligence for the member to participate in the offering and a filing is required to be made with FINRA's Corporate Financing Department. Neither a QIU nor a filing is required if one of three exceptions are met, one of which is that the securities offered have a "bona fide public market." In Regulatory Notice 24-17, FINRA proposed replacing the bona fide market exception with an exception for securities "offered by an issuer that has (1) been reporting under the Exchange Act for at least one year, (2) is current in its reporting requirements and (3) its common equity securities have an aggregate market value of at least $300 million." We refer to the above proposal as the "Proposal," the exception mentioned above as the "New Exception" and the three requirements listed above as the "New Exception Tests."

Suggested Modifications to the Proposal We are writing to propose modifications to the New Exception Tests because the offerings of debt securities and warrants by certain global systemically important banks ("GSIBs") would be ineligible for the New Exception as proposed due to banking regulations to which they are subject. GSIBs are the largest and most systemically important banking institutions, as determined by the Financial Stability Board (the "FSB")[1] We believe modifications are merited in view of the fact that such issuances have attributes that ensure as much or more investor protection than provided by issuers that meet the New Exception Tests as currently drafted.

The Guarantor Modification U.S. banking regulations prohibit the top-tier entity of a U.S. global systemically important bank ("U.S. GSIB Parent"), as a practical matter, from issuing certain types of debt securities and

[1] *See* https://www.fsb.org/2024/11/2024-list-of-global-systemically-important-banks-g-sibs/ for the current FSB list of GSIBs, which indicates the GSIBs that are headquartered in the United States (the "U.S. GSIBs"). A number of U.S. GSIBs have FINRA affiliates.

warrants (the "Securities").[2] As a result of banking law prohibitions, U.S. GSIBs typically issue the Securities from a subsidiary of the U.S. GSIB Parent (the "Subsidiary") and, as permitted by banking regulations, the Securities are guaranteed by the U.S. GSIB Parent. We note that the equity securities of U.S. GSIB parents are traded in the public markets.

The issue described in the previous paragraph arises from the Total Loss-Absorbing Capacity Rule ("TLAC Rule") issued by the Board of Governors of the Federal Reserve ("Federal Reserve") in 2016. To maximize the likelihood that a U.S. GSIB can be resolved (i.e., wound down) in an orderly manner in the case of failure, the TLAC Rule states that a U.S. GSIB Parent can have "unrelated liabilities"[3] of no more than 5% of the total amount of its TLAC (i.e. enumerated types of plain vanilla debt that can absorb losses). Because many liabilities of the U.S. GSIB Parent, including most operating liabilities, are also "unrelated liabilities," as a practical matter, this 5% limit requires the U.S. GSIB to issue the Securities out of a Subsidiary together with a guarantee by the U.S. GSIB Parent.

As noted above, the New Exception Tests look only to the issuer of the security in question and do not take into account an unconditional guarantor of an issuer's liability under the security, whose creditworthiness is as important to the holder of such security as the issuer's creditworthiness because the holder will experience a credit loss only if both the issuer and the guarantor cannot pay. While the structure described above works under U.S. banking regulations and is acceptable to the market, the Securities would not get the benefit of the New Exception because it is typically the U.S. GSIB Parent, rather than the Subsidiary, that has public equity securities referenced by the third prong of the New Exception Tests. This seems to us to be an unintended consequence of the Proposal caused by a conflict between the Proposal and Federal Reserve requirements.

FINRA describes the New Exception Tests as meant to "ensure the company is followed to a meaningful degree by investors and the analyst community" and cites to the "amount of public information available for investors" as an appropriate measurement for purposes of the New Exception. We believe FINRA is correct in focusing on the existence of sufficient public information to ensure that a purchaser of a security is making an informed purchase free of the potential influence of conflicts. In this connection, we note that the U.S. GSIB Parents, acting as guarantors of the Securities, easily meet the New Exception Tests. Each has been a reporting company for far in excess of three years. The market value of each U.S. GSIB Parent's common equity securities is more than 400 times the $300 million threshold in the New Exception Tests.[4] The U.S. GSIB Parents are the financial institutions that arguably have the most publicly available information in the world. As a result, we believe that FINRA's goals would be equally met by expanding the Proposal to make the New Exception available if either the issuer <u>or</u> an unconditional guarantor of the issuer's liabilities under the security meets the New Exception Tests (the "Guarantor Modification").

Without the Guarantor Modification to the New Exception, offerings of the Securities guaranteed by the GSIB Parent would be subject to significant costs and potential delays (e.g., filing fees of $225,500 per shelf filing, which fee will increase each year through 2029, fees payable to QIUs and potential delay in identifying and signing up QIUs to participate in each offering off a shelf). This does not seem equitable or seem to serve any regulatory purpose in view of the extremely high market value of each U.S. GSIB Parent's common equity and copious amount of publicly available information regarding the guarantors in the marketplace. The Guarantor Modification would fix this issue, which is also consistent with the fact that

[2] For purposes of this letter, the "Securities" are "structured notes," as defined under the TLAC Rule described below, which also includes warrants.

[3] An "unrelated liability" is defined as "any non-contingent liability of the [GSIB Parent] owed to a person that is not an affiliate of the [GSIB]." This definition encompasses the Securities. While there are a number of exceptions from the definition of "unrelated liability," the only one potentially relevant to the issuance of the Securities is the exception for "eligible TLAC," but the Securities are not eligible TLAC.

[4] For example, as of December 31, 2024, the market value of the common equity securities of each U.S. GSIB Parent is approximately $334 billion for Bank of America Corporation, approximately $132 billion for Citigroup Inc., approximately $178 billion for The Goldman Sachs Group, Inc., approximately $671 billion for JPMorgan Chase & Co., approximately $202 billion for Morgan Stanley and approximately $231 billion for Wells Fargo & Co.

the purchasers of these Securities look to the U.S. GSIB Parents as their ultimate credit counterparties. We therefore propose that the proposed FINRA Rule 5121(a)(1)(A)(ii)c be amended to include the Guarantor Modification as follows:

"the securities are offered by an issuer, or are unconditionally guaranteed by a guarantor, (i) that has been reporting under the Exchange Act for at least one year, (ii) is current in its reporting requirements, and (iii) that has common equity securities with an aggregate market value of at least $300 million."

Total Equity Modification We also believe there should be a modification to FINRA Proposed Rule 5121(a)(1)(A)(ii)c for debt securities and warrants offered by wholly-owned subsidiaries of non-U.S. GSIBs. These issuers do not meet the third New Exception Test because, as wholly-owned subsidiaries, they do not have publicly traded equity securities.

While such banks are not subject to the TLAC Rule because they are not U.S. GSIBs, they are generally subject to non-U.S. banking regulations, whose regulatory purpose is similar to that of the TLAC Rule. For example, U.K. and EU GSIBs are subject to the Minimum Requirement for own funds and Eligible Liabilities ("MREL"). We have been advised that in certain jurisdictions, structured notes and warrants of such entities are issued by an affiliate because MREL imposes a limit on the amount of non-MREL liabilities (including structured notes and warrants) that these GSIBs can issue, and structured note and warrant issuances at any significant volume would make it challenging to stay within these requirements.

While the affiliates used by such GSIBs to issue non-MREL liabilities have no public equity securities, they have total equity (total assets minus total liabilities) that greatly exceed the market value test in the Proposal. These affiliated issuers also generally file under the Securities Exchange Act and are therefore followed to a meaningful degree by investors and the analyst community. We believe that total equity, as shown in audited financials publicly filed with the SEC, is a substantial equivalent of the test relating to the public market value of the issuer's equity securities. Accordingly, we request that the Proposal be modified to accept total equity as a substitute for aggregate market value for companies that meet the first two requirements of the New Exception Tests (the "Total Equity Modification").

Without the Total Equity Modification to the New Exception, offerings of securities issued by these non-U.S. GSIBs will be subject to the same significant costs and potential delays (e.g., filing fees of at least $225,500 per shelf filing, fees payable to QIUs and potential delay in identifying and signing up QIUs to participate in each offering off a shelf) that would apply to subsidiaries of Restricted Entities without the Guarantor Modification to the New Exception. We therefore recommend that proposed FINRA Rule 5121(a)(1)(A)(ii)c be amended to include the Total Equity Modification. To effect both proposed modifications, we would recommend the following language:

"the securities are offered by an issuer, or are unconditionally guaranteed by a guarantor, (i) that has been reporting under the Exchange Act for at least one year, (ii) is current in its reporting requirements, and (iii) that has common equity securities with an aggregate market value of at least $300 million or with total equity as reported in its publicly filed audited financial statements of at least $300 million."

Elimination of Required Filing Date from the New Exception Tests Under the Proposal, the New Exception Tests must be met by the issuer of securities on the required filing date, as defined in Rule 5110. We agree with the comments of the Subcommittee on FINRA Corporate Financing Rules of the Federal Regulation of Securities Committee of the Business Law Section of the ABA that the use of the term "required filing date" here (in subsection b of proposed revised Rule 5121(a)(1)(A)(ii) as well as subsection c) is incorrect.

Required filing date means the date referenced in Rule 5110(a)(3) or "no later than three business days after any documents are filed with or submitted to...the SEC." When securities are sold pursuant to a registration statement subject to SEC Rule 415, such securities may be sold for three years after the effective date of the registration statement. Therefore, if an exemption from Rule 5121 is required to be determined on the required filing date of a shelf registration statement, an issuer would be reviewing whether it meets the New Exemption Tests three years prior to its offering off the shelf. This is clearly inconsistent with FINRA's approach to the regulation of public offerings.

In addition, for over 30 years, the Corporate Financing Department has advised practitioners that the date on which a determination is made as to whether an exemption from filing is available for a shelf offering is at the time of the offering, not the date of filing a shelf registration statement with the SEC. The inclusion of "required filing date" in these provisions conflicts with the Department's longstanding advice.

We very much appreciate the opportunity to provide comments on the Proposal and are grateful to FINRA staff for its commitment to eliminating unnecessary burdens on capital formation. We and our clients are available at any time to respond to any questions or provide additional information in connection with our recommendations.

Very truly yours,

Marcie Goldstein

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