Regulatory Notice 17-15

Corporate Financing

FINRA Requests Comment on Proposed Amendments to the FINRA Corporate Financing Rule

Comment Period Expires: May 30, 2017

Executive Summary

FINRA seeks comment on proposed amendments to FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) to make substantive, organizational and terminology changes to the rule. The proposal is intended to modernize Rule 5110 and to simplify and clarify its provisions. The proposal would retain the primary principle of the rule that no member firm or person associated with a member firm may participate in a public offering for which the terms and conditions, including the aggregate amount of underwriting compensation, are unfair, unreasonable or inconsistent with any FINRA rule.

The proposed rule text is available in Attachment A. The proposed rule text marked to show changes from the current rule text is available in Attachment B.

In a separate *Regulatory Notice*, FINRA is also requesting comment generally on its rules and programs governing the capital raising process and their effects on capital formation. In response to that *Notice* or this one, commenters are welcome to suggest changes to Rule 5110 beyond those proposed below.[1]

Questions regarding this *Notice* should be directed to:

- Joseph Price, Senior Vice President and Counsel, Corporate Financing/Advertising Regulation, at (240) 386-4642 or *joseph.price@finra.org*;
- Kathryn M. Moore, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8200 or *kathryn.moore@finra.org*; or
- Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013 or *jeanette.wingler@finra.org*.

FINRA

Financial Industry Regulatory Authority

April 2017

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Corporate Finance
- Legal
- Registered Representatives
- Senior Management
- Syndicate
- Underwriting

Key Topics

- Capital Raising
- Convertible Securities
- Distribution of Securities
- Electronic Filing
- Initial Public Offerings
- Investment Banking
- Public Offerings
- Underwriting Compensation
- Venture Capital

Referenced Rules

- FINRA Rule 2341
- FINRA Rule 5110
- FINRA Rule 5121
- Regulation S
- Regulation S-K
- SEC Registration Forms S-3, F-3 and F-10
- Securities Act Rule 144A

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by May 30, 2017.

Comments must be submitted through one of the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Jennifer Piorko Mitchell
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.[2]

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).[3]

Background & Discussion

Rule 5110 prohibits unfair underwriting arrangements in connection with the public offering of securities. This rule was adopted in 1992 in response to persistent problems with underwriters dealing unfairly with issuers. The rule requires a member that participates in a public offering to file information with FINRA about the underwriting terms and arrangements.[4] FINRA's Corporate Financing Department reviews this information prior to the commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of the applicable FINRA rules.[5]

Rule 5110 was last modernized in 2004 to better reflect the various financial activities of multi-service firms. After years of experience with those amendments and subsequent, narrower amendments that addressed industry practices regarding particular underwriting terms and arrangements, FINRA recently conducted the equivalent of a retrospective review of the rule[6] to further modernize it by, among other things, significantly improving the administration of the rule and simplifying its provisions without lessening important protections for market participants, including investors and issuers participating in offerings. FINRA is proposing a range of changes to Rule 5110, including to the following areas:[7]

- filing requirements;
- filing exemptions;
- disclosure requirements;
- underwriting compensation;
- lock-up restrictions;
- valuation of securities;
- prohibited terms and arrangements; and
- defined terms.

Filing Requirements

FINRA is proposing changes to the filing requirements to create a process that is both more flexible and more efficient.[8] For example, FINRA is proposing to allow members more time to make the required filings with FINRA (from one business day after filing with the SEC or state equivalent to three business days),[9] clarify that a member participating in a filing is not required to file with FINRA if the filing is made by another member participating in the offering, and clarify and further reduce the types of documents and information that must be filed.[10] In addition, rather than providing a non-exhaustive list of types of public offerings that are required to be filed, the proposed amendments would instead state that a public offering in which a member participates must be filed for review unless exempted by the rule. Providing firms with more time within which to file relevant documents and reducing the filing of duplicative or otherwise unnecessary documents would lessen firms' filing burdens while maintaining important protections for market participants.

Filing Exemptions

Rule 5110 contains a list of offerings that are exempt from filing, but remain subject to the rule's prohibition on unreasonable underwriting terms and arrangements. FINRA proposes to add to the list of offerings that are exempt from filing follow-on offerings of closed-end "tender offer" funds that routinely make self-tender offers and need to be in continuous distribution to offset net redemptions. Compensation for distribution of tender offer funds will become subject to the limitations in FINRA Rule 2341 (Investment Company Securities). FINRA also proposes to clarify that banks that have unsecured investment grade debt outstanding with a term of issue of at least four years meet an exemption from the filing requirements that is available to corporate issuers.

The proposal would also expand the current list of offerings that are exempt from both the rule's filing requirements and substantive regulation of underwriting terms and arrangements to include public offerings of insurance contracts and unit investment trusts. The proposed changes to the filing exemptions are appropriate because they relate to highly regulated offerings or offerings whose terms are subject to Rule 2341 and the Investment Company Act of 1940. Furthermore, the proposed changes may reduce costs to firms by reducing filing burdens and clarifying the scope of the exemptions.

For purposes of clarity, the proposal would also add an explicit exemption from both the filing requirements and substantive provisions of Rule 5110 for offerings made pursuant to the SEC's Regulation S and Rule 144A under the Securities Act of 1933. These offerings are currently exempt from Rule 5110 because they do not fit within the scope of public offerings covered by the rule but the lack of an explicit exemption has raised questions from firms.

Disclosure Requirements

The SEC's Regulation S-K requires fees and expenses identified by FINRA as underwriting compensation to be disclosed in the prospectus. FINRA is proposing to modify the underwriting compensation disclosure requirements. Although the proposal would continue to require that a description of each item of underwriting compensation be disclosed, it would no longer require the disclosure to include the dollar amount ascribed to each individual item of compensation. FINRA is proposing to permit a firm to disclose the maximum aggregate amount of all underwriting compensation, except the discount or commission that must be disclosed on the cover page of the prospectus. The proposal would also clarify in the Supplementary Material that the rule requires disclosure of any right of first refusal granted to a participating member and its duration, any securities acquired by a participating member, and the material terms and arrangements of the acquisition (*e.g.*, exercise terms, demand rights, piggyback registration rights, lock-up periods). The proposed Supplementary Material also details when finder fees, legal fees and expenses of the participating member may be aggregated with other underwriting expenses in the distribution arrangements section of the offering document. The proposal would strike an appropriate balance by requiring disclosure of material terms and arrangements for the benefit of investors in the public offering, while reducing burdens on firms by not requiring disclosure of the dollar amount ascribed to each item of compensation.

Underwriting Compensation

FINRA is proposing to clarify what is considered underwriting compensation for purposes of Rule 5110. As an initial matter, FINRA is proposing to consolidate the various provisions of the current rule that address what constitutes underwriting compensation into a single, new definition of "underwriting compensation." The proposal would define "underwriting compensation" to mean "any payment, right, interest, or benefit received or to be received by a participating member from any source for underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering." Underwriting compensation would also include "finder fees and underwriter's counsel fees, including expense reimbursements and securities."[11]

The proposal, moreover, would introduce the defined term "review period" and make clear that the applicable period would vary based on the type of offering. FINRA would consider payments and benefits received during the applicable review period in evaluating underwriting compensation.

In the Supplementary Material, the proposal would continue to provide two non-exhaustive lists of examples of payments or benefits that would be and would not be considered underwriting compensation. The proposed examples of payments or benefits that *would* be underwriting compensation reflect our current interpretations with some clarifying changes (*e.g.*, fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including road show fees and expenses and due diligence expenses).

The proposed examples of payments or benefits that would *not* be underwriting compensation include current items[12] and several new examples to provide greater clarity and to address questions raised by firms. For example, in response to questions from firms, FINRA is proposing to clarify that payments for management and advisory services received by members in connection with bank and insurance company corporate reorganizations would not be considered underwriting compensation. Similarly, FINRA is proposing to clarify that the payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer would not be considered underwriting compensation. These payments are beyond the traditional scope of underwriting services and, therefore, are appropriately excluded from the rule's coverage.

The proposal would also modify and clarify exceptions from the term "underwriting compensation." Currently, the rule provides five exceptions from that definition. FINRA proposes to no longer treat as underwriting compensation securities acquisitions covered by two of the exceptions (1) securities acquisitions and conversions to prevent dilution and (2) purchases based on a prior investment history. This treatment is conditioned on prior investments in the issuer occurring before the review period. When subsequent securities acquisitions take place (*e.g.*, as a result of a stock split, a right of preemption, a securities conversion, or when additional securities are acquired to prevent dilution of a long-standing interest in the issuer), the acquisition of the additional securities should not be treated as underwriting compensation. The proposal would add these acquisitions to the list of payments that are *not* underwriting compensation because they are based on a prior investment history and are subject to the terms of the original securities that were acquired before the review period.

The three remaining exceptions address securities that were acquired prior to the required filing date as a result of bona fide investments and loans and that meet specified conditions. The proposal would broaden two of the exceptions regarding purchases and loans by certain affiliates, and investments in and loans to certain issuers by removing a limitation on acquiring more than 25 percent of the issuer's total equity securities. The exceptions are designed to distinguish securities acquired in bona fide venture capital transactions from those acquired as underwriting compensation.

The 25 percent threshold limits each member and its affiliates from acquiring more than 25 percent of the issuer's total equity securities, which typically establishes a control relationship. The threshold, which was codified in 2004, provided protection from overreaching by firms at a time when FINRA was concerned with limiting the aggregate amount of equity acquired in pre-offering transactions. Subsequent regulatory changes in other areas, such as the modernization of the rule regulating public offerings with a conflict of interest in 2009,[13] have added protections and are more appropriate to address acquisitions that create control relationships.

The final remaining exception governs private placements with institutional investors. Under this exception syndicate members in the aggregate may acquire no more than 20 percent of the securities sold in the private placement. FINRA is proposing to change this threshold from 20 percent to 40 percent. Such private placements typically occur before the syndicate is formed and, therefore, firms do not know at the time whether their participation in the private placement would impact the issuer's future public offering by triggering the threshold. Because exceeding the threshold would subject firms that purchased on the same terms as the other investors to the compensation limits, disclosure and lock-up provisions of the rule, the 20 percent threshold reduces the number of firms available for the syndicate. Increasing the threshold would allow more firms to participate in the private placement and any subsequent public offering. An increase in the threshold is appropriate and raising it to 40 percent: (1) would not materially change the operation of the exception, as the securities acquired in the private placement would remain subject to the other conditions in the exception; and (2) would benefit issuers that are in the process of assembling a syndicate.

Lock-Up Restrictions

Subject to some exceptions, Rule 5110 requires a 180-day lock-up restriction on securities that are considered underwriting compensation.[14] Because a prospectus may become effective long before the commencement of sales, FINRA proposes that the lock-up period begin on the date of commencement of sales (rather than the date of effectiveness of the prospectus).

FINRA is also proposing to modify the exceptions from the lock-up restriction (*e.g.*, by adding exceptions for securities of an issuer that meets the registration requirements of SEC Registration Forms S-3, F-3 or F-10 due to the existing public market for securities of these issuers and for acquired securities that are subject to an underwriting compensation exemption or do not meet the definition of underwriting compensation). In addition, FINRA is proposing that the lock-up restriction not prohibit: (1) the transfer of any security to the member's registered persons or affiliates if all transferred securities remain subject to the restriction for the remainder of the lock-up period; or (2) the transfer or sale of the security back to the issuer in a transaction exempt from registration with the SEC,[15] because these transfers or sales do not involve the types of underwriting services covered by Rule 5110.

Valuation of Securities

Rule 5110 currently prescribes specific calculations for valuing convertible and non-convertible securities received as underwriting compensation. However, applying these calculations can be time and resource intensive for both firms and FINRA. Rather than the specific calculations currently in the rule, FINRA is proposing in the Supplementary Material to instead allow valuing options, warrants and other convertible securities received as underwriting compensation based on a securities valuation method that is commercially available and appropriate for the type of securities to be valued (*e.g.*, the Black-Scholes model for options).[16] The proposed change for valuing convertible securities would ensure a commercially reasonable valuation of underwriting compensation for the benefit of issuers and the public while easing administrative and operational burdens for firms and FINRA.

Prohibited Terms and Arrangements

FINRA is proposing to clarify the list of prohibited terms and arrangements in connection with a public offering of securities and eliminate from the list the prohibition of a non-accountable expense reimbursement in excess of 3 percent of the offering proceeds. Non-accountable expense reimbursements are subject to the overall cap, and it is unnecessary to have a 3 percent "cap within a cap." Its elimination will remove the need for firms to monitor separately the receipt of this particular type of compensation.

Defined Terms

In addition to consolidating the defined terms in one location, FINRA is proposing to simplify and clarify the defined terms. Most notably, the proposal would make the terminology more consistent throughout the rule's various provisions. For example, as discussed above, the proposal would introduce a single definition of "underwriting compensation." In addition, the proposal would add consistency to the scope of persons covered by the rule. Rule 5110 currently alternates between using the defined term "underwriter and related persons" (which includes underwriter's counsel, financial consultants and advisors, finders, any participating member, and any other persons related to any participating member) and the defined term "participating member" (which includes any FINRA member that is participating in a public offering, any affiliate or associated person of the member and any immediate family). To provide greater clarity and consistency on the scope of persons covered by a provision, FINRA is proposing to delete the term "underwriter and related persons" and instead use the defined term "participating member." The proposed definition of underwriting compensation would ensure that the rule continues to address fees and expenses paid to persons previously covered by the term "underwriter and related persons" (*e.g.*, underwriter's counsel fees and expenses, financial consulting and advisory fees and finder fees).[17]

In addition, the proposal would modernize the rule language (*e.g.*, by replacing references to specific securities exchanges to instead reference the definition of "national securities exchange" in the SEA). Further, FINRA is proposing new definitions to provide greater predictability (*e.g.*, "associated person," "experienced issuer,"[18] "equity-linked securities," "public offering," "review period" and "overallotment option"). In addition, the proposal would conform the definition in FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) by deleting the definition of "public offering" in that rule and instead incorporating the definition in Rule 5110 by reference.

Economic Impact Assessment

Need for the Rule

The Corporate Financing Rule was approved by the SEC in 1992.[19] Over the years, it has been amended a number of times to better reflect the evolving market conditions and financial activities of firms. Based on FINRA's recent review of the rule and feedback from firms, the rule and FINRA's administration of it may benefit from major revisions including organizational, terminology and substantive changes. The proposal is intended to modernize the rule, simplify its provisions, make the rule more comprehensible, and improve its administration. The increased regulatory efficiency is expected to enhance compliance with the rule and the protection of issuers, investors and public interest.

Economic Baseline

The economic baseline for the proposal is the current rule and FINRA's current interpretation of it. As further discussed below, the proposal is expected to affect firms that provide underwriting services, issuers seeking to access the public capital markets and investors in public offerings.

In 2015, FINRA received 1,399 public offerings (covering both equity and debt securities), representing 280 firms and 1,030 issuers. While on average each firm participated in 14 filings, the median number of filings in which a firm participated was only three, indicating that the most active firms were involved in many more filings than the remaining firms. The total proceeds of the 1,399 filings were over $144 billion, with a median of approximately $18 million per filing. These figures are substantially reduced from prior years because of reduced public capital raising.

Economic Impact Assessment

The proposal overall is expected to significantly improve the clarity, consistency and organization of FINRA Rule 5110. This would reduce the administrative and operational burdens for firms and FINRA, promote regulatory efficiency, enhance market functioning, and strengthen issuer and investor protection.

The proposal includes organizational and terminology changes to simplify the rule and substantive changes to better reflect current market conditions, practices and standards. Given the large number of proposed changes, FINRA has identified the changes that are likely to have potentially material impacts on market participants for the purposes of this discussion.

Valuation of Securities

FINRA is proposing to require firms to use commercially available and appropriate methods for valuation of convertible securities instead of the specific calculations prescribed by the current rule. To the extent that the methods adopted by members are reasonable and fair, the change may modernize and improve the valuation of convertible securities, contribute to the integrity of the public capital markets and heighten investor protection. Moreover, firms and FINRA would no longer need to ensure compliance with the specific calculations prescribed by the current rule. This may reduce administrative and operational burdens for firms and FINRA as the current process is time and resource intensive.

The proposal would also impose new initial costs on firms and FINRA. Firms would have to select and acquire an appropriate methodology, file with FINRA a description of the methodology, and document and monitor the application of the methodology to ensure compliance with the proposal. Similarly, FINRA would need to establish policies and procedures to evaluate various valuation methods and ensure consistency in the evaluation.

Underwriting Compensation

The proposed changes related to exceptions from underwriting compensation may also have potentially significant impacts. The changes generally would make the exceptions more available to firms.

For example, FINRA is proposing to broaden two exceptions by removing the limitation on acquiring more than 25 percent of the issuer's total equity securities. Similarly, for the exception related to private placements with institutional investors, FINRA is proposing to change the threshold in the requirement that the participating members did not acquire more than a certain percentage of the total offering from the current 20 percent to 40 percent of the total offering.

Making the exceptions more available would provide firms with greater operational and financial flexibility. As noted above, increasing the 20 percent threshold to 40 percent would likely benefit issuers by increasing the number of firms available to participate in private placements and subsequent public offerings. However, more exceptions may also have negative impacts on issuer and investor protection if more financial activities that are potentially related to underwriting compensation would not be governed by the rule. FINRA does not expect the proposed changes to have significant negative impacts. The current thresholds of 25 percent of the issuer's total equity securities and 20 percent of the total offering were designed to distinguish securities acquired in *bona fide* investments from underwriting compensation. Because subsequent regulatory changes have added protections and are more appropriate to address control relationships, the negative impact of removing the threshold of 25 percent, if any, should be minimal. Increasing the 20 percent threshold to 40 percent would have limited impact on issuer and investor protection as the exception has other meaningful provisions acting as safeguards.

Filing Exemptions

The proposal would modify the list of offerings that are exempt from filing, but remain subject to the substantive provisions of Rule 5110, to include public offerings of closed-end "tender offer" funds that meet certain conditions. The compensation paid for these funds would be governed instead by Rule 2341. The exemption may materially reduce costs to firms as the number of such offerings is expected to be large. It would have minimal impact on issuer and investor protection as the current practice already exempts most of these offerings from the underwriting compensation requirements of Rule 5110.

Disclosure Requirements

FINRA is proposing to clarify the underwriting compensation disclosure requirements in Rule 5110. Under the proposal, the prospectus would no longer need to include the dollar amount ascribed to each individual item, but would need to include the maximum aggregate amount of all underwriting compensation. The proposed change would reduce compliance costs for members. FINRA does not believe that the dollar amounts associated with individual components add additional disclosure value, given that individual components will be described and the aggregate dollar amount of compensation will be disclosed to issuers and investors.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following issues.

1. What are the alternative approaches, other than the proposal, that FINRA should consider?
2. Are there any ways in which FINRA administers Rule 5110, including the operations and processes it uses to receive or review filings that should be modified? If so, how?
3. In 2015, the SEC approved final rules to facilitate smaller companies' access to capital that are commonly referred to as Regulation A+. What is the impact of Rule 5110 on underwriting services currently being provided in offerings pursuant to Regulation A+? Would the proposal impact the scope of underwriting services currently being provided in these offerings? What if any improvements could FINRA adopt to its treatment of Regulation A+ offerings?
4. With respect to the exception from underwriting compensation related to private placements with institutional investors, the proposal would increase the threshold from 20 percent to 40 percent in the condition that limits members of the syndicate in the aggregate to acquiring no more than 20 percent of the securities sold in the private placement. Is this change in the threshold appropriate? Should the threshold be higher or lower? Similarly, does the proposal to remove the limitation on acquiring more than 25 percent of the issuer's total equity securities as underwriting compensation have any potential negative impact on issuer and investor protection?
5. Prior to 2004, Rule 5110 contained a "stock numerical limit" that prohibited underwriters and related persons from receiving securities that constitute underwriting compensation in an aggregate amount greater than ten percent of the number or dollar amount of securities being offered to the public.[20] FINRA eliminated this requirement as unnecessary as the required warrant formula results in a de facto stock numerical limit. If Rule 5110 is amended to eliminate the warrant formula, should a new stock numerical limit be included?
6. The proposal would allow the value of options, warrants and other convertible securities received as underwriting compensation to be based on a securities valuation method that is commercially available and appropriate for the type of securities to be valued, such as, for example, the Black-Scholes model for options. Is this change appropriate? Should the valuation model be limited to one that is commercially available?

7. Are there any material economic impacts, including costs and benefits, to investors, issuers and firms that are associated specifically with the proposal? If so:

   a. What are these economic impacts and what are their primary sources?

   b. To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?

   c. What would be the magnitude of these impacts, including costs and benefits?

8. Are there any expected economic impacts associated with the proposal not discussed in this *Notice*? What are they and what are the estimates of those impacts?

Endnotes

1. *See Regulatory Notice 17-14* (April 2017).

2. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.

3. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.

4. Filings of public offerings are made electronically with FINRA through FINRA's public offering filing system accessible at *https://www.finra.org/industry/public-offerings*. The filing and review process are described on the "Public Offerings" page available on the FINRA.org website. The following are some examples of public offerings that are routinely filed: (1) initial public offerings; (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs as defined in FINRA Rule 2310(a)(4); (6) offerings by real estate investment trusts; (7) offerings by a bank or savings and loan association; (8) exchange offerings; (9) offerings pursuant to SEC Regulation A; and (10) offerings by closed-end funds.

5. FINRA does not approve or disapprove of an offering; rather, the review relates solely to the FINRA rules governing underwriting terms and arrangements and does not purport to express any determination of compliance with any federal or state laws, or other regulatory or self-regulatory requirements regarding the offering. A firm may only proceed with a public offering if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.

6. Because the review began before April 2014, it did not follow the specific retrospective review procedures used in subsequent retrospective reviews.

7. The proposal does not include any changes to current Rule 5110(h) (Non-Cash Compensation). These provisions are the subject of a separate consolidated approach to non-cash compensation. *See Regulatory Notice 16-29* (August 2016).

8. Participating members are responsible for filing public offerings with FINRA. While an issuer may file an offering with FINRA if a participating member has not yet been engaged, a participating member must assume filing responsibilities once it has been engaged. In the case of a shelf offering, an issuer may file a base shelf registration statement in anticipation of retaining a member to participate in a takedown, but a participating member must file documents and information regarding the takedown once it has been engaged.

   Participating members currently have access to summary information concerning their filings through the Public Offering Dashboard, a tool available to participating members through the Firm Gateway that shows the status of each filing made on behalf of the participating member. Each participating member's Super Account Administrator is responsible for granting employees access to the Dashboard.

9. Filers must provide a link to documents filed with the SEC (*e.g.*, registration statements) through the documents' SEC accession number. Documents filed confidentially with the SEC and other documents that do not have an SEC accession number must be filed as separate attachments in the "Non-SEC Filed Documents" section of the filing system.

10. For example, FINRA is requiring filing of: (1) industry-standard master forms of agreement *only* if specifically requested to do so by FINRA; (2) amendments to previously filed documents *only* if there have been changes to the offering and underwriting terms and arrangements in those documents; and (3) a representation, among other things, as to whether any associated person or affiliate of a participating member is a beneficial owner of 5 percent or more of *only* equity and equity-linked securities.

11. In considering whether the aggregate underwriting compensation that participating members receive in connection with a public offering is fair and reasonable, FINRA takes into account the following factors: (1) the anticipated maximum amount of offering proceeds; (2) whether the offering is being distributed on a firm commitment or best efforts basis; and (3) whether the offering is an initial or follow-on offering.

    The amount of permissible underwriting compensation for an offering is typically expressed as a percentage of the proposed maximum offering proceeds, and this percentage generally increases as the offering size decreases. The maximum permissible compensation percentage is typically higher for a firm commitment offering than a best efforts offering of the same size, which recognizes the risks and expenses of committing capital to an offering. The maximum permissible compensation also is typically higher for an IPO than a follow-on offering of the same size, which recognizes the higher cost of underwriting an offering for an issuer without an established market for its securities.

12. For example, non-convertible or non-exchangeable debt securities and derivatives instruments acquired in a transaction that is unrelated to the public offering are not deemed to be underwriting compensation. Consistent with the requirements of the rule today, the proposal in the Supplementary Material clarifies that if the securities are acquired in connection with the public offering and at a fair price the securities will be considered underwriting compensation but will have no compensation value. Securities acquired in a transaction that is related to the public offering but not at a fair price will be considered underwriting compensation and subject to the valuation requirements of the rule and related disclosure of the valuation methodology.
13. Rule 5121 governing conflicts of interest requires prominent disclosure of conflicts and, for certain types of conflicts, the participation of a qualified independent underwriter in the preparation of the registration statement.
14. During the lock-up period, securities are restricted from sale or transfer and may not be pledged as collateral or made subject to any derivative contract or other transaction that provides the effective economic benefit of sale or other prohibited disposition. Securities acquired by a member that are not considered underwriting compensation are not subject to the lock-up provisions of Rule 5110.
15. The proposal would retain the current exception to the lock-up for the exercise or conversion of any security, if all such securities received remain subject to the lock-up restriction for the remainder of the 180-day lock-up period.
16. The proposal would require members to file with FINRA a description of the methodology used to value any security received or to be received as underwriting compensation.
17. Substantively consistent with the current rule, the proposal would define “participating member” to include any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family other than the issuer. While not included in the “participating member” definition, the broad definition of underwriting compensation would include underwriter’s counsel fees and expenses, financial consulting and advisory fees and finder fees. As such, the definition of underwriting compensation would ensure that the rule addresses fees and expenses paid to persons previously covered by the term “underwriter and related persons.”
18. The proposal would delete references to the pre-1992 standards for Form S-3 and standards approved in 1991 for Form F-10 and instead codify the requirement that the issuer have a 36-month reporting history and at least $150 million aggregate market value of voting stock held by non-affiliates (alternatively, $100 million aggregate market value of voting stock held by non-affiliates and an annual trading volume of at least three million shares). Issuers meeting this standard would be defined as “experienced issuers” and their public offerings would be exempt from filing, but subject to the substantive provisions of Rule 5110.
19. *See* SEA Release No. 30587 (April 15, 1992), 57 FR 14597 (April 21, 1992) (Order Approving File No. SR-NASD-91-19).
20. The number or dollar amount of securities subject to the limit was calculated to exclude: (1) any securities deemed to be underwriting compensation; (2) any securities issued pursuant to an overallotment option; (3) in the case of a best efforts offering, any securities not actually sold; and (4) any securities underlying warrants, options or convertible securities that are part of the proposed offering.