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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2019 - * 012
Amendment No. (req. for Amendments *)

Filing by Financial Industry Regulatory Authority

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☑	☐	☐	☑	☐	☐

Pilot	Extension of Time Period for Commission Action *	Date Expires *
☐	☐	

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change Relating to FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) to Make Substantive, Organizational and Terminology Changes

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Jeanette Last Name * Wingler
Title * Associate General Counsel
E-mail * jeanette.wingler@finra.org
Telephone * (202) 728-8013 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 04/11/2019
By Patrice Gliniecki
(Name *)

(Title *)
Senior Vice President and Deputy General Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Patrice Gliniecki,

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information * Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) (the "Rule") to make substantive, organizational and terminology changes to the Rule. The proposed rule change is intended to modernize Rule 5110 and to simplify and clarify its provisions while maintaining important protections for market participants, including issuers and investors participating in offerings. The proposed rule change would also update cross-references and make other non-substantive changes within FINRA rules due to the proposed amendments to Rule 5110.

The text showing the proposed rule change as if adopted is attached as Exhibit 4. The text of the proposed rule change is attached as Exhibit 5.[2]

(b) Not applicable.

(c) Not applicable.

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

2 The proposed rule change amends and reorganizes the Rule. Note that in Exhibit 5 where entire paragraphs of the Rule are being moved, paragraphs that are moved to a new location in the Rule are not marked if there are no changes to the text of the paragraph. If, however, there are changes to the text of a paragraph that is being relocated, the proposed new language in the paragraph is underlined and proposed deletions are bracketed.

2. Procedures of the Self-Regulatory Organization

At its meeting on March 7, 2017, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

If the Commission approves the proposed rule change, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 90 days following Commission approval. The implementation date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Since its adoption in 1992 in response to persistent problems with underwriters dealing unfairly with issuers, Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in connection with the public offering of securities. Moreover, Rule 5110 continues to be important to ensuring investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

Rule 5110 requires a member that participates in a public offering to file documents and information with FINRA about the underwriting terms and arrangements.[3] FINRA's Corporate Financing Department ("Department") reviews this

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3 The following are examples of public offerings that are routinely filed: (1) initial public offerings ("IPOs"); (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs ("DPPs") as defined in

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.[4]

Rule 5110 was last revised in 2004 to better reflect the various financial activities of multi-service members.[5] 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[6] to further modernize the Rule by, among other things, significantly improving the administration of the Rule and simplifying the Rule's provisions while

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FINRA Rule 2310(a)(4) (Direct Participation Programs); (6) offerings by real estate investment trusts ("REITs"); (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.

4 FINRA does not approve or disapprove 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 member may proceed with a public offering only if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements. See current Rule 5110(b)(4)(B)(ii). See also proposed Rule 5110(a)(1)(C)(ii).

5 In recognition of the expansion in the variety of services provided by members to their corporate financing clients, such as venture capital investment, financial consulting, commercial lending, hedging risk through derivative transactions and investment banking services, the Rule was revised in 2004 to accommodate the expanded corporate financing activities of members, while protecting issuers and investors from unreasonable or coercive practices. See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

6 Because the review began before FINRA initiated formal retrospective review procedures, it did not follow the specific procedures that are now followed.

maintaining important protections for market participants, including issuers and investors participating in offerings.

As part of this retrospective review, FINRA engaged in extensive consultation with the industry to better understand what aspects of the Rule needed to be modernized, simplified and clarified. This retrospective review, including its industry consultation component and comments FINRA received in response to Regulatory Notice 17-15 (April 2017) ("Notice 17-15 Proposal") (as further discussed in Items 4 and 5 infra), has shaped and informed this proposed rule change. The proposed rule change includes a range of amendments to Rule 5110, including reorganizing and improving the readability of the Rule. FINRA proposes changes to the following areas: (1) filing requirements; (2) filing requirements for shelf offerings; (3) exemptions from filing and substantive requirements; (4) underwriting compensation; (5) venture capital exceptions; (6) treatment of non-convertible or non-exchangeable debt securities and derivatives; (7) lock-up restrictions; (8) prohibited terms and arrangements; and (9) defined terms.[7] The changes to these areas should lessen the regulatory costs and burdens incurred when complying with the Rule.

Filing Requirements

The proposed rule change would amend Rule 5110's filing requirements to create a process that is both more flexible and more efficient for members. The proposed rule

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7 As discussed below, the proposal retains the current approach to itemized disclosure of underwriting compensation, but makes explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation, such as exercise terms, in the prospectus. In addition, the proposed rule change 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).

change would allow members more time to make the required filings with FINRA (from one business day after filing with the SEC or a state securities commission or similar state regulatory authority to three business days).[8] This change is intended to help with logistical issues or inadvertent delays in making filings without impeding FINRA's ability to timely review the underwriting terms and arrangements.

The proposed rule change would clarify and further reduce the types of documents and information that must be filed by directing members to provide the SEC document identification number if available,[9] and require filing: (1) industry-standard master forms of agreement only if specifically requested to do so by FINRA;[10] (2) amendments to previously filed documents only if there have been changes relating to the disclosures that impact the underwriting terms and arrangements for the public offering in those documents;[11] (3) a representation as to whether any associated person or affiliate of a participating member is a beneficial owner of 5 percent or more of "equity and equity-

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8 See proposed Rule 5110(a)(3)(A). The documents and information required to be filed under Rule 5110 are filed in FINRA's Public Offering System ("FINRA System") for review and, if available, the associated SEC document identification number should be provided. See proposed Rule 5110(a)(4).

9 Depending on the filing type, an SEC document identification number could include a document control number, document file number or accession number. For purposes of clarity, the lack of an SEC document identification number does not obviate the need to submit the documents and information set forth in proposed Rule 5110(a)(4).

10 See proposed Rule 5110(a)(4)(A)(ii). A member may use a master form of agreement which is a standard form used across like offerings and transactions in which the member participates (e.g., a master agreement among underwriters).

11 See proposed Rule 5110(a)(4)(A)(iii).

linked securities";[12] and (4) an estimate of the maximum value for each item of underwriting compensation.[13]

The proposed rule change would clarify that a member participating in an offering is not required to file with FINRA if the filing has been made by another member participating in the offering.[14] In addition, rather than providing a non-exhaustive list of types of public offerings that are required to be filed, the proposed rule change would instead state that a public offering in which a member participates must be filed for review unless exempted by the Rule.[15] The proposed rule change would clarify the general standard that no member may engage in the distribution or sale of securities unless FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.[16] The proposed rule change also would clarify that any member acting as a managing underwriter or in a similar capacity must notify the other members participating in the public offering if informed of an opinion by FINRA that the underwriting terms and arrangements are unfair and unreasonable and the

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12 See proposed Rule 5110(a)(4)(B)(iii) and proposed Rule 5110(j)(7). Contrast with current Rule 5110(b)(6)(A)(iii), which requires a statement or association related to "any class of the issuer's securities."

13 See proposed Rule 5110(a)(4)(B)(ii).

14 See proposed Rule 5110(a)(3)(B). 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. As discussed infra, issuer filings continue to be permitted for shelf offerings.

15 See proposed Rule 5110(a)(2). As discussed infra, the proposed rule change would add the defined term "public offering" to Rule 5110.

16 See proposed Rule 5110(a)(1)(C).

proposed terms and arrangements have not been appropriately modified.[17] Providing members with more time to file relevant documents and information and reducing the filing of duplicative or otherwise unnecessary documents and information would lessen members' filing burdens while maintaining the Rule's important protections for market participants.

The new provision addressing terminated offerings provides that, when an offering is not completed according to the terms of an agreement entered into by the issuer and a member, but the member has received underwriting compensation, the member must give written notification to FINRA of all underwriting compensation received or to be received, including a copy of any agreement governing the arrangement.[18] Information regarding underwriting compensation received or to be received in terminated offerings is relevant to FINRA's evaluation of compliance with Rule 5110 and, in particular, paragraph (g)(5) of the proposed Rule. This new provision would allow FINRA to provide more effective oversight when a member's services have been terminated.

Filing Requirements for Shelf Offerings

Issuers meeting specified reporting history and other requirements are eligible to use shelf registration statements. A shelf-eligible issuer can use a shelf takedown to

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17 See proposed Rule 5110(a)(1)(B).

18 See proposed Rule 5110(a)(4)(C) and proposed Rule 5110(g)(5). In 2014, FINRA amended Rule 5110 to expand and specify the circumstances under which underwriting compensation in excess of a reimbursement of out-of-pocket expenses, such as termination fees and rights of first refusal ("ROFR"), could be received in connection with an offering that was not completed or when a member was terminated from an offering. See Securities Exchange Act Release No. 72114 (May 7, 2014), 79 FR 27355 (May 13, 2014) (Order Approving File No. SR-FINRA-2014-004).

publicly offer securities on a continuous or delayed basis to meet funding needs or to take advantage of favorable market windows. Public offerings by some shelf-eligible issuers have historically been exempt from Rule 5110's filing requirement; however, for the reasons discussed below, public offerings by other shelf-eligible issuers have historically been subject to Rule 5110's filing requirement. The proposed rule change would codify the historical standards for public offerings that are exempt from the filing requirement and would streamline the filing requirements for shelf offerings that remain subject to the filing requirement.

Public Offerings Exempt from the Filing Requirement

Substantively consistent with the current Rule, the proposed rule change would exempt from Rule 5110's filing requirement a public offering by an "experienced issuer" (i.e., an issuer with a 36-month reporting history and at least $150 million aggregate market value of voting stock held by non-affiliates or, alternatively, the aggregate market value of voting stock held by non-affiliates is at least $100 million and the issuer has an annual trading volume of three million shares or more in the stock).[19] Unless subject to another exemption, public offerings of issuers that do not meet the reporting history or float requirement to be codified in the experienced issuer definition have historically been subject to Rule 5110's filing requirement, including shelf offerings by these issuers.

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[19] The proposed rule change 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 or alternatively the aggregate market value of voting stock held by non-affiliates is at least $100 million and the issuer has an annual trading volume of three million shares or more in the stock. See proposed Rule 5110(j)(6).

Public Offerings Subject to the Filing Requirement

There are many benefits for eligible issuers in using a shelf registration statement, including the ability of issuers to take advantage of favorable market conditions on short notice to quickly raise capital through takedown offerings. While shelf offerings have historically been less likely to have compliance problems, previously filed shelf offerings have given rise to issues under Rule 5110, including those related to: (1) excessive underwriting compensation; (2) indeterminate underwriting compensation in the form of convertible debt or equity securities that do not have a market value; (3) undisclosed underwriting compensation, primarily in the form of uncapped expense reimbursements; and (4) termination fees and ROFRs that do not satisfy the Rule's requirements.

Given the issues that have arisen in shelf offerings, the proposed rule change would continue to apply Rule 5110's filing requirement to shelf offerings by issuers that do not meet the "experienced issuer" standard. However, to facilitate the ability of issuers to take advantage of favorable market conditions on short notice to quickly raise capital through takedown offerings, the proposed rule change would streamline the filing requirements for shelf offerings. The proposed rule change would provide that only the following documents and information must be filed: (1) the Securities Act of 1933 ("Securities Act") registration statement number; and (2) if specifically requested by FINRA, other documents and information set forth in Rule 5110(a)(4)(A) and (B).[20]

FINRA would access the base shelf registration statement, amendments and prospectus supplements in the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system and populate the information necessary to conduct a review in the

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[20] See proposed Rule 5110(a)(4)(E).

FINRA System. Upon filing of the required registration statement number and documents and information, if any, that FINRA requested pursuant to proposed Rule 5110(a)(4)(E), FINRA would provide the no objections opinion. To further facilitate issuers' ability to timely access capital markets, FINRA's review of documents and information related to a shelf takedown offering for compliance with Rule 5110 would occur on a post-takedown basis.[21]

Exemptions from Filing and Substantive Requirements

Rule 5110 includes two categories of exempt public offerings – offerings that are exempt from filing, but remain subject to the substantive provisions of Rule 5110, and offerings that are exempt from both the filing requirements and substantive provisions of Rule 5110. The proposed rule change would expand and clarify the scope of the exemptions, which is expected to reduce members' filing and compliance costs.

Consistent with historical practice in interpreting the exemption that is currently available to corporate issuers, the proposed rule change would clarify that securities of banks that have qualifying outstanding debt securities are exempt from the filing requirement.[22]

The proposed rule change would also expand the current list of offerings that are exempt from both the filing requirements and substantive provisions of Rule 5110 to include public offerings of closed-end "tender offer" funds (i.e., closed-end funds that

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21 Issuers would continue to be permitted to file a base shelf registration statement in anticipation of retaining a member to participate in a takedown offering.

22 See proposed Rule 5110(h)(1)(A). The exemption has historically been interpreted to apply to qualifying securities offered by a bank; however, the lack of a specific reference to bank securities in the Rule text has raised questions by members.

repurchase shares from shareholders pursuant to tender offers), insurance contracts and unit investment trusts.[23] Exempting these public offerings is appropriate because they relate to highly regulated entities governed by the Investment Company Act of 1940 ("Investment Company Act") whose offering terms would be subject to FINRA Rule 2341 (Investment Company Securities). In addition, as discussed infra, in response to comments to the Notice 17-15 Proposal, the proposed rule change reclassifies three items from the offerings exempt from filing and rule compliance to offerings excluded from the definition of public offering. The three items are: (1) offerings exempt from registration with the SEC pursuant to Section 4(a)(1), (2) and (6) of the Securities Act; (2) offerings exempt from registration under specified SEC Regulation D provisions; and (3) offerings of exempted securities as defined in Section 3(a)(12) of the Exchange Act. This reclassification is consistent with the treatment of such offerings in FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest).[24]

Disclosure Requirements

The SEC's Regulation S-K requires fees and expenses identified by FINRA as underwriting compensation to be disclosed in the prospectus.[25] The Notice 17-15 Proposal would have modified Rule 5110's underwriting compensation disclosure requirements. Although a description of each item of underwriting compensation would have been required to be disclosed, the Notice 17-15 Proposal would have no longer required that the disclosure include the dollar amount ascribed to each individual item of

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23 See proposed Rule 5110(h)(2)(E), (K) and (L).

24 See proposed Rule 5110(j)(18).

25 See 17 CFR 229.508(e).

compensation. Rather, the Notice 17-15 Proposal would have permitted a member 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.

FINRA is no longer proposing to eliminate the itemized disclosure that Rule 5110 currently requires. As discussed in Item 5 infra, commenters had conflicting views on the proposed change to allow aggregation of underwriting compensation with one commenter stating that the itemized disclosure may be beneficial for investors in better understanding the underwriting compensation paid and incentives that may be present in the public offering. Recognizing commenters' conflicting views, the proposed rule change would retain the current requirements for itemized disclosure of underwriting compensation and disclosing dollar amounts ascribed to each such item.[26] The proposed rule change would incorporate the requirements for disclosure of specified material terms and arrangements that are consistent with current practice.[27]

The Notice 17-15 Proposal also included an explicit requirement to disclose specified material terms and arrangements in the prospectus. The current proposal includes the same obligation, which makes explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation in the prospectus. This explicit provision would require a description for: (1) any ROFR granted to a participating member and its duration; and (2) the material terms and

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26 See proposed Rule 5110(b)(1) and Supplementary Material .05 to Rule 5110. See also proposed Rule 5110(e)(1)(B) requiring disclosure of lock-ups.

27 See proposed Supplementary Material .05 to Rule 5110.

arrangements of the securities acquired by the participating member (e.g., exercise terms, demand rights, piggyback registration rights and lock-up periods).[28]

Underwriting Compensation

The proposed rule change would clarify what is considered underwriting compensation for purposes of Rule 5110. As an initial matter, the proposed rule change would consolidate the various provisions of the current Rule that address what constitutes underwriting compensation into a single, new definition of "underwriting compensation." Underwriting compensation would be defined 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's fees, underwriter's counsel fees and securities."[29]

Rule 5110 currently provides that all items of value received or to be received from any source are presumed to be underwriting compensation when received during the period commencing 180 days before the required filing date of the registration statement, and up to 90 days following the effectiveness or commencement of sales of a public offering.[30] However, this approach may not reflect the various types of offerings subject to Rule 5110. For example, a best efforts offering may be distributed for months or years and underwriters may receive compensation throughout the offering period, or a base

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28 See proposed Supplementary Material .05 to Rule 5110.

29 See proposed Rule 5110(j)(22).

30 See current Rule 5110(d)(1). See also current Rule 5110(b)(6)(A)(vi)b. which provides that details of any new arrangement entered into within 90 days following the date of effectiveness or commencement of sales of the public offering must be filed.

shelf registration statement may become effective months or years before a takedown offering for which an underwriter is compensated.

To better reflect the different types of offerings subject to Rule 5110, the proposed rule change would introduce the defined term "review period" and the applicable time period would vary based on the type of offering. Specifically, the proposed rule change would define the review period to mean: (1) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering; (2) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and (3) for a firm commitment or best efforts takedown or any other continuous offering made pursuant to Securities Act Rule 415, the 180-day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.[31] Accordingly, payments and benefits received during the applicable review period would be considered in evaluating underwriting compensation.

The proposed rule change would continue to provide two non-exhaustive lists of examples of payments or benefits that would be and would not be considered underwriting compensation.[32] Although the Rule would no longer incorporate the concept of "items of value" (i.e., the non-exhaustive list of payments and benefits that would be included in the underwriting compensation calculation), the proposed non-exhaustive lists are derived from the examples of payments or benefits that currently are

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[31] See proposed Rule 5110(j)(20).

[32] See proposed Supplementary Material .01 to Rule 5110.

considered and not considered items of value. The proposed examples of payments or benefits that would be underwriting compensation is comparable to the list of items of value in the current Rule with some additional clarifying changes. For example, the proposed rule change would expand the current item of value related to reimbursement of expenses to provide that fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses, would be underwriting compensation.[33] Consistent with current practice, the proposed rule change would also include in underwriting compensation non-cash compensation.[34]

The proposed examples of payments or benefits that would not be underwriting compensation include several new examples to provide greater clarity and to address questions raised by members. For instance, in response to questions from members, the proposed rule change would clarify that payments for records management and advisory services received by members in connection with some corporate reorganizations would not be considered underwriting compensation.[35] Similarly, the proposed rule change would clarify that the payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer would not be considered

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33 See proposed Supplementary Material .01(a)(2) to Rule 5110. See also proposed Supplementary Material .01(a)(3) and (4) to Rule 5110 which includes fees and expenses of participating members' counsel and finder's fees paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement of "blue sky" fees) as underwriting compensation.

34 See proposed Supplementary Material .01(a)(14) to Rule 5110.

35 See proposed Supplementary Material .01(b)(3) to Rule 5110.

underwriting compensation.[36] The proposed rule change also would clarify that securities acquired pursuant to a governmental or court approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding) would not be considered underwriting compensation.[37] These payments are for services beyond the traditional scope of underwriting activities and, therefore, are appropriately excluded from the coverage of Rule 5110.

In addition, to give members reasonable flexibility with respect to issuer securities acquired in certain circumstances, the proposed rule change would take a principles-based approach in considering whether issuer securities acquired from third parties or in directed sales programs may be excluded from underwriting compensation. This principles-based approach starts with the presumption that the issuer securities received during the review period would be underwriting compensation. However, FINRA would consider the factors set forth in proposed Supplementary Material to Rule 5110 and discussed below in determining whether the securities may be excluded from underwriting compensation.[38] A participating member is responsible for providing documents and information sufficient for FINRA to consider in applying the factors to a particular securities acquisition.

With respect to issuer securities received from third parties, it is important to note that the proposed definition of "underwriting compensation" would include payments, rights, interests, or benefits received or to be received by a participating member from

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36 See proposed Supplementary Material .01(b)(4) to Rule 5110.

37 See proposed Supplementary Material .01(b)(22) to Rule 5110. See also comments from ABA, Davis Polk and SIFMA discussed in Item 5 infra.

38 See proposed Supplementary Material .03 and. 04 to Rule 5110.

any source for underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering. However, some acquisitions of issuer securities from third parties for purposes unconnected to underwriting compensation should not be deemed underwriting compensation (e.g., securities acquired in ordinary course transactions executed over a participating member's trading desk during the review period from third parties).

To address these situations, the proposed rule change uses a principles-based approach to considering whether securities of the issuer acquired from third parties may be excluded from underwriting compensation. Specifically, under proposed Supplementary Material .03 to Rule 5110, FINRA would consider the following factors, as well as any other relevant factors and circumstances: (1) the nature of the relationship between the issuer and the third party, if any; (2) the nature of the transactions in which the securities were acquired, including, but not limited to, whether the transactions are engaged in as part of the participating member's ordinary course of business; and (3) any disparity between the price paid and the offering price or market price.

With respect to issuer securities acquired in directed sales programs (commonly called friends and family programs), it is important to note that the proposed definition of "participating member" includes any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family of an associated person of the member, but does not include the issuer.[39] However, associated persons and their immediate family members may have relationships with issuers that motivate the issuer to sell these persons shares in directed sales programs.

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[39] See proposed Rule 5110(j)(15).

These acquisitions may be unrelated to the investment banking services provided by the participating member.

To address these situations, under the proposed rule change FINRA would take a principles-based approach to considering whether an acquisition of securities by a participating member pursuant to an issuer's directed sales program may be excluded from underwriting compensation. Specifically, under proposed Supplementary Material .04 to Rule 5110, FINRA would consider the following factors, as well as any other relevant factors and circumstances: (1) the existence of a pre-existing relationship between the issuer and the person acquiring the securities; (2) the nature of the relationship; and (3) whether the securities were acquired on the same terms and at the same price as other similarly-situated persons participating in the directed sales program.

Venture Capital Exceptions

Rule 5110 currently provides exceptions designed to distinguish securities acquired in bona fide venture capital transactions from those acquired as underwriting compensation (for brevity, referred to herein as the "venture capital exceptions").[40] Recognizing that bona fide venture capital transactions contribute to capital formation, the proposed rule change would modify, clarify and expand the exceptions to further facilitate members' participation in bona fide venture capital transactions. Importantly, the venture capital exceptions would include several restrictions to ensure the protection of other market participants and that the exceptions are not misused to circumvent the requirements of Rule 5110.

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[40] See current Rule 5110(d)(5).

The proposed rule change would no longer treat as underwriting compensation securities acquisitions covered by two of the current exceptions: (1) securities acquisitions and conversions to prevent dilution; and (2) securities 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. Accordingly, the proposed rule change would add these acquisitions to the list of examples 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.[41]

The proposed rule change also would broaden two of the current venture capital 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.[42] 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 members at a time when there was a concern about limiting the aggregate amount of equity acquired in pre-offering transactions. Subsequent regulatory changes in other areas, such as the 2009 revision of

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41 See proposed Supplementary Material .01(b)(14), (16-18).

42 See proposed Rule 5110(d)(1) and (2).

Rule 5121 regarding public offerings with a conflict of interest,[43] have added protections and are more appropriate to address acquisitions that create control relationships.

These venture capital exceptions specify that the affiliate must be primarily in the business of making investments or loans. The proposed rule change expands the scope of these exceptions to include that the affiliate, directly or through a subsidiary it controls, must be in such business and further permits that the entity may be newly formed by such affiliate. Expanding the scope of the exceptions to cover direct, indirect or newly formed entities that are in the business of making investments and loans acknowledges the different structures that may be used to participate in bona fide venture capital transactions.[44]

Another venture capital exception relates to private placements with institutional investors. The exception would be available only when the institutional investors participating in the offering are not affiliates of a FINRA member. This ensures that such institutional investors are independent sources of capital. The provision is further clarified to require that the institutional investors must purchase at least 51 percent of the total number of securities sold in the private placement at the same time and on the same terms. In addition, the proposed rule change would raise the percent that participating members in the aggregate may acquire from 20 to 40 percent of the securities sold in the private placement.[45] These private placements typically occur before the syndicate is

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[43] Rule 5121 requires prominent disclosure of conflicts and, for certain types of conflicts, the participation of a qualified independent underwriter ("QIU") in the preparation of the registration statement.

[44] See proposed Rule 5110(d)(1)(D) and (d)(2)(A)(iv).

[45] See proposed Rule 5110(d)(3)(C).

formed and, therefore, members may 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 members to the compensation limits, disclosure provisions and lock-up provisions of the Rule, the current 20 percent threshold reduces the number of members available for the syndicate. Increasing the threshold would allow more members 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.

In response to comments to the Notice 17-15 Proposal, the proposed rule change would expand the scope of proposed Rule 5110(d)(3) to include providing services for a private placement (rather than just acting as a placement agent).[46] Members' roles in acting as placement agents and in providing other services in private placements (e.g., acting as a finder or a financial advisor) similarly facilitate offerings. As such, expanding the current venture capital exception beyond securities received for acting as a placement agent to include securities received for providing services for a private placement is appropriate.

Where a highly regulated entity with significant disclosure requirements and independent directors who monitor investments is also making a significant co-investment in an issuer and is receiving securities at the same price and on the same terms

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46 See proposed Rule 5110(d)(3) and Item 5 infra.

as the participating member, the securities acquired by the participating member in a private placement are less likely to be underwriting compensation. To address such co-investments, the proposed rule change would adopt a new venture capital exception from underwriting compensation for securities acquired in a private placement before the required filing date of the public offering by a participating member if at least 15 percent of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that is an open-end investment company not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering. These conditions lessen the risk that the co-investment would be made for the purpose of providing undervalued securities to a participating member in return for acting as an underwriter.

A public offering may be significantly delayed for legitimate reasons (e.g., unfavorable market conditions) and during this delay the issuer may require funding. Furthermore, a member may make bona fide investments in or loans to the issuer during this delay to satisfy the issuer's funding needs and any securities acquired as a result of this funding may be unrelated to the anticipated public offering. The proposed rule change would provide some additional flexibility in the availability of the venture capital exceptions for securities acquired where the public offering has been significantly delayed.

The proposed rule change would take a principles-based approach where a public offering has been significantly delayed and the issuer needs funding in considering whether it is appropriate to treat as underwriting compensation securities acquired by a member after the required filing date in a transaction that, except for the timing, would otherwise meet the requirements of a venture capital exception. This principles-based approach starts with the presumption that the venture capital exception would not be available where the securities were acquired after the required filing date. However, FINRA would consider the factors in proposed Supplementary Material .02 in determining whether securities acquired in a transaction that occurs after the required filing date, but otherwise meets the requirements of a venture capital exception, may be excluded from underwriting compensation.

Specifically, FINRA would consider the following principles, as well as any other relevant factors and circumstances: (1) the length of time between the date of filing of the registration statement or similar document and the date of the transaction in which securities were acquired; (2) the length of time between the date of the transaction in which the securities were acquired and the anticipated commencement of the public offering; and (3) the nature of the funding provided, including, but not limited to the issuer's need for funding before the public offering. A participating member is responsible for providing documents and information sufficient for FINRA to consider in applying the principles to a particular securities acquisition.

Treatment of Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

The proposed rule change would clarify the treatment of non-convertible or non-exchangeable debt securities and derivative instruments.[47] The proposed rule change would expressly provide that non-convertible or non-exchangeable debt securities and

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47 Consistent with the current Rule, the proposed rule change would define the term "derivative instrument" to mean any eligible OTC derivative instrument as defined in Exchange Act Rule 3b-13(a)(1), (2) and (3). See proposed Supplementary Material .06(b) to Rule 5110.

derivative instruments acquired in a transaction unrelated to a public offering would not be underwriting compensation.[48] Accordingly, the non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction unrelated to a public offering would not be subject to Rule 5110 (i.e., a description of the non-convertible or non-exchangeable debt securities and derivative instruments need not be filed with FINRA,[49] there are no valuation-related requirements and the lock-up restriction does not apply).

In contrast, non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to a public offering would be underwriting compensation. For any non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering, the proposed rule change would clarify that: (1) a description of those securities and derivative instruments must be filed with FINRA; and (2) this description must be accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price.[50]

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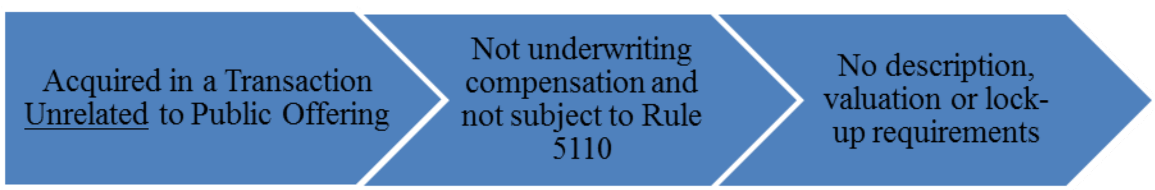
48 See proposed Supplementary Material .01(b)(19) to Rule 5110.

49 See proposed Rule 5110(a)(4)(B)(iv)b.

50 See proposed Rule 5110(a)(4)(B)(iv)a. Generally consistent with current Rule 5110, the proposed rule change would define the term "fair price" to mean the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm's length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. The proposed rule change would also clarify that a derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be

The proposed rule change would also clarify that the valuation depends upon whether the non-convertible or non-exchangeable debt securities or derivative instruments acquired in a transaction related to a public offering were or were not acquired at a fair price. Specifically, the proposed rule change would clarify that non-convertible or non-exchangeable debt securities and derivative instruments acquired at a fair price would be considered underwriting compensation but would have no compensation value. In contrast, the proposed rule change would provide that non-convertible or non-exchangeable debt securities and derivative instruments not acquired at a fair price would be considered underwriting compensation and subject to the normal valuation requirements of Rule 5110.[51]

The following charts provide an overview of the treatment of non-convertible or non-exchangeable debt securities and derivative instruments under Rule 5110.



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entered into or acquired at a fair price. See proposed Supplementary Material .06(b) to Rule 5110.

[51] See proposed Supplementary Material .06(a) to Rule 5110 and proposed Rule 5110(c).

Lock-Up Restrictions

Subject to some exceptions, Rule 5110 requires in any public equity offering a 180-day lock-up restriction on securities that are considered underwriting compensation. During the lock-up period, securities that are underwriting compensation 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.[52] Because a prospectus may become effective long before the commencement of sales, the proposed rule change would provide that the lock-up period begins on the date of commencement of sales of the public equity offering (rather than the date of effectiveness of the prospectus).[53] The proposed rule change also would provide that the lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document consistent with proposed Supplementary Material .05 requiring disclosure of the material terms of any securities.[54]

The proposed rule change would add exceptions from the lock-up restriction for clarity or to except securities where other protections or market forces obviate the need for the restriction. Due to the existing public market for securities of the issuers, the proposed rule change would add an exception from the lock-up restriction for securities acquired from an issuer that meets the registration requirements of SEC Registration

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52 Consistent with the current Rule, securities acquired by a member that are not considered underwriting compensation would not be subject to the lock-up restrictions of Rule 5110.

53 See proposed Rule 5110(e)(1)(A).

54 See proposed Rule 5110(e)(1)(B).

Forms S-3, F-3 or F-10.[55] The proposed rule change would also add an exception from the lock-up restriction for securities that were acquired in a transaction meeting one of Rule 5110's venture capital exceptions.[56] While these securities would not be considered underwriting compensation and, thus, not subject to the lock-up restriction, the exception would provide additional clarity with respect to these securities.

The proposed rule change would also add an exception from the lock-up restriction for securities that were received as underwriting compensation and are registered and sold as part of a firm commitment offering.[57] This is intended to give some flexibility to members in selling securities received as underwriting compensation, while limiting the proposed exception to firm commitment offerings where the underwriter has assumed the risk of marketing and distributing an offering that includes securities the underwriter received as underwriting compensation. In addition, firm commitment offers are usually marketed and sold to institutional investors, who typically purchase a majority of the shares in such offerings.

The proposed rule change would provide clarity about the treatment of non-convertible or non-exchangeable debt securities and derivative instruments acquired in transactions related to a public offering.[58] The following charts provide an overview of the application of Rule 5110's lock-up requirement to non-convertible or non-exchangeable debt securities and derivative instruments.

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55 See proposed Rule 5110(e)(2)(A)(iii).

56 See proposed Rule 5110(e)(2)(A)(vi).

57 See proposed Rule 5110(e)(2)(A)(viii) and Item 5 discussion infra.

58 See proposed Rule 5110(e)(2)(A)(iv).

Non-convertible or non-exchangeable debt securities acquired in a transaction related to the public offering	Not subject to Rule 5110 lock-up requirement
Derivative instruments acquired in a transaction related to the public offering	Subject to Rule 5110 lock-up requirement
Derivative instruments acquired in a hedging transaction related to the public offering at a fair price	Excepted from the Rule 5110 lock-up restriction

The proposed rule change also addresses members' acquisition of derivative instruments in connection with hedging transactions related to a public offering. For example, fixed-for-floating swaps are commonly used in hedging transactions in connection with offerings of debt securities. These hedging transactions would not be effective if the derivative securities were subject to lock-up restrictions. Accordingly, the proposed rule change would provide that the lock-up restriction does not apply to derivative instruments acquired in connection with a hedging transaction related to the public offering and at a fair price.[59] Derivative instruments acquired in transactions related to the public offering that do not meet the requirements of the exception would continue to be subject to the lock-up restriction.

In addition, the proposed rule change would add an exception to the lock-up restriction to permit the transfer or sale of the security back to the issuer in a transaction

59 See proposed Rule 5110(e)(2)(A)(v).

exempt from registration with the SEC.[60] These transactions do not put selling pressure on the secondary market that the lock-up is designed to prevent. The proposed rule change would also modify the lock-up exception in current Rule 5110(g)(2)(A)(ii) to permit 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.[61]

Finally, because proposed Supplementary Material .01(b)(20) would provide that securities acquired subsequent to the issuer's IPO in a transaction exempt from registration under Securities Act Rule 144A would not be underwriting compensation, the proposed rule change would correspondingly delete as unnecessary the current exception from the lock-up restriction for those securities.[62]

Prohibited Terms and Arrangements

Rule 5110 includes a list of prohibited unreasonable terms and arrangements in connection with a public offering of securities. The proposed rule change would clarify and amend the list, such as clarifying the scope of relevant activities that would be deemed related to the public offering[63] and referring to the commencement of sales of the

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60 See proposed Rule 5110(e)(2)(B)(iii).

61 See proposed Rule 5110(e)(2)(B)(i). The proposed rule change 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. See proposed Rule 5110(e)(2)(B)(ii).

62 See current Rule 5110(g)(2)(A)(viii).

63 See proposed Rule 5110(g)(11). Specifically, to clarify the scope, the proposed rule change would refer to "solicitation, marketing, distribution or sales of the offering" rather than the current "distribution or assisting in the distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting."

public offering (rather than the date of effectiveness) in relation to the receipt of underwriting compensation consisting of any option, warrant or convertible security with specified terms.[64]

The proposed rule change would also clarify that it would be considered a prohibited arrangement for any underwriting compensation to be paid prior to the commencement of sales of public offering, except: (1) an advance against accountable expenses actually anticipated to be incurred, which must be reimbursed to the issuer to the extent not actually incurred; or (2) advisory or consulting fees for services provided in connection with the offering that subsequently is completed according to the terms of an agreement entered into by an issuer and a participating member.[65] The proposed rule change recognizes the practical issue that certain fees and expenses, including advisor or consultant fees, may be incurred before the offering is sold and allows such fees so long as the services are in connection with an offering that is completed in accordance with the agreement between the issuer and the participating member.

The proposed rule change would also simplify a provision that relates to payments made by an issuer to waive or terminate a ROFR to participate in a future capital-raising transaction.[66] The application of this provision has been challenging for members, particularly in circumstances where the terms of the future offering had not been negotiated at the time of the proposed public offering. The proposed rule change would,

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[64] See proposed Rule 5110(g)(8).

[65] See proposed Rule 5110(g)(4).

[66] See current Rule 5110(f)(2)(F)(i).

however, retain the prohibition on any non-cash payment or fee to waive or terminate a ROFR.[67]

Defined Terms

In addition to consolidating the defined terms in one location at the end of the Rule, the proposed rule change would simplify and clarify Rule 5110's defined terms. Most notably, the proposed rule change would make the terminology more consistent throughout the Rule's various provisions. For example, the proposed rule change would consolidate the various provisions of the current Rule that address what constitutes underwriting compensation into a single, new definition of "underwriting compensation."[68]

The proposed rule change would also add consistency and clarity 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)[69] 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).[70] The proposed rule change would eliminate the term "underwriter and related persons" and instead use the defined term "participating member." However, the proposed definition of

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67 See proposed Rule 5110(g)(7).

68 See proposed Rule 5110(j)(22).

69 See current Rule 5110(a)(6).

70 See current Rule 5110(a)(4).

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's fees).[71]

The proposed rule change would move the definition of "public offering" from Rule 5121 to Rule 5110.[72] The term "public offering" is used frequently in Rule 5110 and moving it into the Rule should simplify compliance. The definition would be modified to add "made in whole or in part in the United States" to clarify the jurisdictional scope of the definition. The proposed rule change would also move, without modification, the definition of "Net Offering Proceeds" from Rule 5110 to Rule 5121 because the term is used only in Rule 5121.[73]

In addition, the proposed rule change would modernize Rule 5110's language (e.g., by replacing references to specific securities exchanges to instead reference the

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[71] Substantively consistent with the current Rule, the proposed rule change 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," but does not include the issuer. See proposed Rule 5110(j)(15). 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's 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." In addition, the term "immediate family" is clarified for readability in proposed Rule 5110(j)(8) to mean the spouse or child of an associated person of a member and any relative who lives with, has a business relationship with, or provides to or receives support from an associated person of a member.

[72] See proposed Rule 5110(j)(18). Rule 5121 would incorporate the definition in Rule 5110 by reference. See Rule 5121(f).

[73] See proposed Rule 5121(f)(9).

definition of "national securities exchange" in the Exchange Act). Furthermore, the proposed rule change would include new defined terms to provide greater predictability for members in applying the Rule (e.g., "associated person," "experienced issuer,"[74] "equity-linked securities," "overallotment option" and "review period").

The proposed rule change would incorporate the definition of "associated person" in Article I, Section (rr) of the FINRA By-Laws. In response to comments on the Notice 17-15 Proposal, the proposed rule change would also harmonize the definition of bank in the proposed venture capital exceptions and the exemption in proposed Rule 5110(h)(1). Specifically, the proposed rule change would state that a bank is "a bank as defined in Exchange Act Section 3(a)(6) or is a foreign bank that has been granted an exemption under this Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates." In addition, in response to comments and to clarify the scope of covered persons, the proposed rule change would revise the issuer definition to refer to the "registrant or other person" (rather than "entity" as initially proposed in the Notice 17-15 Proposal).

Valuation of Securities

Rule 5110 currently prescribes specific calculations for valuing convertible and non-convertible securities received as underwriting compensation. Rather than the

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[74] As discussed supra, the proposed rule change 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 or more 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. See proposed Rule 5110(j)(6).

specific calculations in the current Rule, the Notice 17-15 Proposal would have instead allowed 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). As discussed in Item 5 infra, commenters had conflicting views on the proposed change to the valuation formula and did not provide any information regarding alternative commercially available valuation methods that may be used by members. As a result, the proposed rule change would retain the current methods for valuing options, warrants and other convertible securities received as underwriting compensation in the current Rule.[75]

As noted in Item 2 supra, if the Commission approves the proposed rule change, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[76] 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.

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[75] See proposed Rule 5110(c).

[76] 15 U.S.C. 78o-3(b)(6).

The proposed rule change would facilitate capital formation by modernizing Rule 5110. The proposed rule change would simplify the provisions of the Rule, make it more comprehensible, and improve its administration.

For example, the proposed rule change is expected to clarify what is considered "underwriting compensation." In addition, the proposed rule change would make the venture capital exceptions more available to members and not impinge on bona fide investments in, and loans to, issuers. In general, the proposed rule change would provide members with greater operational and financial flexibility, and reduce compliance costs.

The proposed rule change would maintain important protections for issuers and investors participating in offerings. The proposed rule change also would not decrease its ability to oversee underwriting terms and arrangements.

In totality, the proposed rule change would reduce the administrative and operational burdens for members and FINRA, promote regulatory efficiency, and enhance market functioning while maintaining issuer and investor protection.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. All members would be subject to the proposed amendments.

Economic Impact Assessment

FINRA considered the economic impacts on members when devising the proposed rule change. A discussion of the economic impacts is below.

Regulatory Need

Rule 5110 was last revised in 2004, and since then the capital markets and financial activities of member firms have continued to evolve.[77] The proposed change would modernize Rule 5110 through a range of amendments. The proposed change would simplify and clarify the Rule, and better align the Rule with current market practices.

Economic Baseline

The economic baseline for the proposed rule change is current Rule 5110 and its interpretation by FINRA. The proposed rule change is expected to affect participating members, issuers and investors that participate in public offerings.

Rule 5110 regulates the underwriting terms and arrangements in connection with the public offering of securities. The primary function of the Rule is to protect issuers (and their investors at the time of the offering) from unfair underwriting terms and arrangements. Unfair underwriting terms and arrangements increase the costs to issuers of raising capital, potentially leading to a less efficient allocation of capital and thereby imposing a restriction on issuers that need to access capital markets.

The Rule also provides protections for issuers and investors through lock-up restrictions. The restrictions reduce the ability of participating members to utilize the information they gather as part of the underwriting process to opportunistically sell the securities they acquire as compensation in the secondary market (i.e., informed selling).[78]

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77 See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

78 Participating members may have greater ability to engage in informed selling soon after the commencement of sales when they may have additional

The lock-up restrictions thereby decrease the likelihood that participating members use the securities to extract undue compensation from issuers, and decrease the likelihood that investors in the secondary market purchase securities when the securities are overvalued. The exposure of investors to informed selling decreases as time elapses and more information about the issuer becomes available.

Member firms that participate in offerings, however, incur costs to comply with Rule 5110. The costs to members include filing and disclosure requirements, limits to direct and indirect compensation, and restrictions on financial and investment activities. These costs decrease the return to members when participating in offerings.

Rule 5110 requires participating members to file documents and information with FINRA. FINRA reviews the information to determine whether underwriting terms and arrangements meet the requirements of the Rule. To the extent possible, this economic impact analysis will quantify the economic effects of the proposed rule change using the information that FINRA collects through its administration of Rule 5110. The analysis will otherwise discuss the economic effects qualitatively.

In 2017, FINRA received 1,553 filings related to public offerings (covering both equity and debt securities). The filings represent at least 274 members and 1,071 issuers. The total amount of offering proceeds of the filings were over $151 billion, with a median value of approximately $38 million per filing.[79]

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information than other market participants. As more information becomes publicly available, the ability of participating members to engage in informed selling decreases.

79 The 1,553 filings include shelf offerings. FINRA does not require filing, in all cases, the total amount of offering proceeds related to these filings.

Currently, members that participate in fewer offerings are likely to incur higher marginal costs to interpret and comply with Rule 5110. In 2017, the median number of filings in which a member participated was three. This means that approximately half of the members (148 of 274 members) participated in three or fewer offerings. In addition, a large number of these members (85) participated in only one offering.[80]

Economic Impact

The proposed amendments would directly impact member firms that regularly engage in underwriting, issuers that engage member firms for those services, and the investors that seek to participate in those offerings. This economic impact analysis seeks to identify the broad impacts associated with modernizing Rule 5110, as well as specific amendments related to the acquisition of securities, lock-up restrictions, filing requirements, and exemptions for offerings that relate to highly regulated entities.

Modernization

Overall, the proposed change would modernize Rule 5110 by simplifying and clarifying its provisions, and by increasing the consistency of the Rule with current practice. The simplification and clarification of the Rule would decrease the compliance costs of member firms that participate in offerings. The decrease in compliance costs includes the time and expense of internal employees to interpret the Rule, as well as the potential expenses associated with outside legal counsel or other outside experts. The simplification and clarification would also decrease the opportunity costs to participating members from not acquiring securities so as to not violate the permitted compensation

[80] In addition, approximately one-quarter of members (71) participated in ten or more offerings, whereas ten percent of members (27) participated in 50 or more offerings. The maximum number of offerings that any one member participated in was 155.

arrangements under the Rule. Members that participate in fewer offerings would experience a greater decrease in marginal costs from the proposed rule changes.

As a result of the simplification and clarification of Rule 5110, the underwriting terms and arrangements members negotiate with issuers are more likely to be in compliance with the Rule, and the documents and information members file with FINRA are more likely to meet the regulatory requirements of the rule. This may decrease the amount of time that FINRA needs to evaluate the underwriting terms and arrangements and provide an opinion. A decrease in the time needed for FINRA to provide an opinion could potentially enhance the ability of issuers to access capital markets faster provided the concurrent review conducted by the SEC staff has concluded and an offering can be declared effective.

Securities Acquisitions Not Considered Underwriting Compensation

The proposed rule change addresses whether the securities and derivative instruments that participating members acquire are considered underwriting compensation. The amendments relate to securities acquired from third parties for purposes unrelated to underwriting compensation, investments or loans to the issuer when a public offering has been significantly delayed, and non-convertible or non-exchangeable debt securities and derivative instruments unrelated to a public offering.[81] The amendments also broaden two current venture capital exceptions, and adopt a new venture capital exception.[82]

81 See proposed Supplementary Material .02, .03, .04, and .06 to Rule 5110.

82 See proposed Rule 5110(d)(1), (2), and (4). Among the 1,553 filings FINRA received relating to public offerings in 2017, 17 (one percent of 1,553) relate to the current venture capital exceptions under 5110(d)(5).

In general, the proposed rule change would provide participating members additional flexibility and clarity with respect to whether the securities and derivative instruments they acquire would be subject to the compensation limits and lock-up restrictions of Rule 5110. The proposed rule change would therefore decrease the constraints on participating members to engage in transactions in the ordinary course of business and obtain the commissions and trading profits therefrom. The proposed rule change would also decrease the constraints on participating members to engage in hedging transactions and thereby manage their risk exposures.

The venture capital exceptions would increase the total percentage of shares that participating members may acquire without being considered underwriting compensation under Rule 5110, and as a result may increase the number of members that participate in an offering. The proposed amendments to the venture capital exceptions, therefore, would increase the number of financial options and amount of capital available for issuers. The proposed amendments may also improve the market for offerings.[83] The venture capital exceptions would thereby promote capital formation.

Conversely, the proposed amendments to the venture capital exceptions allowing underwriters to acquire additional securities not considered underwriting compensation may increase potential conflicts of interest. These acquisitions may create a control

83 See Shane A. Corwin & Paul Shultz, The Role of IPO Underwriting Syndicates: Pricing, Information Production, and Underwriter Competition, 60(1) Journal of Fin. 443-486 (2005). The authors find that larger syndicates increase information production, analyst coverage, and the number of market makers following the offering.

relationship, potentially resulting in a participating member having a conflict of interest and increasing the costs to issuers and investors.[84]

Two requirements, however, serve to mitigate against these potential costs to issuers. FINRA Rule 5121 specifically addresses the conflicts of interest of participating members and requires disclosure of the conflicts. Further, the proposed amendments also include a requirement that the securities participating members acquire is at the same price and with the same terms as the securities purchased by all other investors. This is intended to ensure that the securities participating members acquire are not for providing undervalued securities as a form of underwriting compensation.

An increase in the percentage of shares that participating members acquire that is not subject to Rule 5110 may also impose costs on investors. The securities and derivative instruments that participating members acquire would not be subject to lock-up restrictions, and may increase the exposure of investors in the secondary market to informed selling. As described in further detail below and subject to some exceptions, the proposed rule change would decrease investor exposure to informed selling by amending the lock-up restrictions under the Rule.

Lock-up Restrictions

The proposed rule change would specify that, consistent with current practice, the lock-up period begins on the date of commencement of sales instead of the date of effectiveness of the prospectus.[85] This would ensure that at least 180 days must pass after

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[84] One commenter expressed concern that removing the restriction in current Rule 5110(d)(5)(A) and (B) may increase the potential for conflicts of interest to arise. See NASAA.

[85] See proposed Rule 5110(e)(1)(A).

the commencement of sales before participating members may sell the securities that they receive as underwriting compensation. This amendment would only impose economic effects on offerings that otherwise would have begun the lock-up period on the date of the effectiveness of the prospectus. For these offerings, investors would have a longer exposure to informed selling from the date of the commencement of sales, and participating members would have a longer exposure to fluctuations in security values from the date of the commencement of sales. In the experience of FINRA staff, however, any longer exposure would be minimal.

The proposed rule change would provide exceptions to the lock-up restrictions.[86] Although the exceptions to the lock-up restrictions would provide flexibility and reduce the investment risk of participating members, the exceptions may also increase the exposure of investors to informed selling. The scope of the proposed exceptions, however, reduce the likelihood that investors purchasing the securities would be at an informational disadvantage. One exception is for securities acquired from an issuer that meet the registration requirements of SEC Registration Forms S-3, F-3 or F-10. These registration requirements relate to issuers with existing public markets for their securities. Other proposed exceptions to the lock-up provisions are for sales as part of a firm commitment offering (which are usually marketed and sold to institutional investors) and sales back to the issuer.[87]

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[86] See proposed Rule 5110(e)(2)(A)(iii) and (viii), and (B)(iii).

[87] Among the 1,553 filings FINRA received relating to public offerings in 2017, 778 relate to firm commitment offerings. The proceeds of the offerings were over $110 billion, or approximately three-quarters of the total proceeds relating to all filings. The median proceeds were $60 million. The largest maximum proposed offering proceeds registered was $2.7 billion. Information describing issuers that

Filing Requirements

In general, the proposed rule change would decrease or streamline the filing requirements of participating members. For example, unless otherwise required by FINRA, participating members would not be required to provide documents relevant to the underwriting terms and arrangements if industry-standard master forms of agreement are used. In addition, participating members would not be required to submit amendments to previously filed documents unless the changes impact the underwriting terms and arrangements.[88] The decrease in filing requirements would decrease the compliance costs of participating members. The costs for members include the time and expense of legal counsel and other internal staff to prepare and submit the filings.

The proposed changes in filing requirements would decrease the documents and information that participating members file with FINRA. FINRA does not believe, however, that the decrease in the documents and information it receives would reduce its ability to evaluate underwriting terms and arrangements and provide protections to issuers and investors. The documents and information are often duplicative or otherwise unnecessary, or can be accessed through other means.[89]

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meet the registration requirements of SEC Registration Forms S-3, F-3 or F-10 or sales back to the issuer is not available.

88 See proposed Rule 5110(a)(4)(A) and (E).

89 For example, proposed Rule 5110(a)(4)(E) would streamline the filing requirements for shelf offerings. A participating member would file the Securities Act registration number, and the documents and information set forth in proposed Rule 5110(a)(4)(A) and (B) only if specifically requested by FINRA. Otherwise, FINRA would access the base shelf registration statement, amendments, and prospectus supplements through the SEC's EDGAR system to conduct the review.

In some instances, however, the proposed rule change would increase the filing requirements of participating members. For example, a new provision would require participating members of terminated offerings to provide written notification of all underwriting compensation received or to be received.[90] The new requirements would increase the costs to participating members to file documents and information with FINRA. The new requirements, however, would increase the ability of FINRA to oversee underwriting terms and arrangements, and provide protections to issuers and investors.

Exemptions for Highly Regulated Entities

Lastly, the proposed rule change would expand the current list of offerings that are exempt from its filing requirements and its substantive provisions.[91] The offerings relate to highly regulated entities whose offering terms would continue to be subject to FINRA Rule 2341. The regulatory protections for issuers and investors would therefore remain, but participating members would no longer incur the costs to comply with Rule 5110.

Offerings that are subject only to FINRA Rule 2341 are not required to be filed with FINRA. In the experience of FINRA staff, however, few filings currently made pursuant to Rule 5110 are also subject to Rule 2341. FINRA therefore does not expect that the costs and benefits of the proposed amendments relating to these offerings would be material.

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90 See proposed Rule 5110(a)(4)(C) and proposed Rule 5110(g)(5).

91 See proposed Rule 5110(h)(2)(E), (K), and (L). The proposed Rule would also clarify that securities of banks that have qualifying outstanding debt securities are exempt from the filing requirement. See proposed Rule 5110(h)(1)(A).

Alternatives Considered

FINRA considered several alternatives in developing the proposed rule change. FINRA explored how to modernize the Rule and how to simplify and clarify its provisions, while maintaining the protections for issuers and investors.

One alternative to the proposed rule change would be to modify or eliminate the filing requirement for shelf-offerings by issuers that do not meet the "experienced issuer" standard.[92] Although a modification or elimination of the filing requirement would decrease the compliance costs of participating members, it could increase the exposure of these issuers to unfair and unreasonable underwriting terms and arrangements. FINRA believes that the decrease in compliance costs under this alternative would not justify the increased risk of harm to issuers.

A second alternative would allow participating members to value options, warrants, and other convertible securities they receive as underwriting compensation with common or commercially available valuation methods. The alternative methods could increase the accuracy of the valuations but also their variability across offerings and members. The alternative valuation methods could reduce the ability of issuers and participating members to agree to terms and the ability of FINRA staff to evaluate the underwriting terms and arrangements, and thereby increase the amount of time for issuers to access capital markets.[93] FINRA will therefore retain the current valuation methods.

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92 See, e.g., ABA and Sullivan.

93 Commenters to the Notice 17-15 Proposal also had conflicting views on the proposed change to the valuation formula, and did not provide any information regarding commercially available valuation methods. See, e.g., NASAA and SIFMA.

A third alternative, which was proposed in the Notice 17-15 Proposal, would no longer require the disclosure of the dollar amount ascribed to each individual item of underwriter compensation in the prospectus. Instead, participating members could aggregate the underwriting expenses for all items, except for the discount or commission. This alternative would have decreased the compliance costs of participating members. It could have also decreased the ability of investors to understand the underwriting terms and arrangements, however, and to decide whether to participate in the offerings.[94]

Other alternatives include different thresholds relating to the proposed amendments to the venture capital exceptions.[95] An increase in the amount of securities that participating members may acquire before triggering the provisions of the Rule would benefit issuers by increasing the number of members available to participate in private placements and subsequent public offerings. However, broader exceptions may reduce issuer and investor protections if more activities that are potentially not underwriting compensation are not governed by these provisions of Rule 5110. The proposed rule change maintains several restrictions to ensure the protection of other market participants, including issuers and investors, and is justified by its benefits including the further promotion of capital formation.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in the Notice 17-15 Proposal. FINRA received 11 comment letters in response to the Notice 17-15 Proposal.

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94 Commenters to the Notice 17-15 Proposal had conflicting views on the proposed change to the disclosure of each individual item of underwriter compensation. See, e.g., ADISA and NASAA.

95 See proposed Rule 5110(d).

A copy of the Notice 17-15 Proposal is attached as Exhibit 2a. Copies of the comment letters received in response to the Notice 17-15 Proposal are attached as Exhibit 2c.[96]

FINRA has considered the concerns raised by commenters and, as discussed in detail below, has addressed many of the concerns noted by commenters in response to the Notice 17-15 Proposal. The comments and FINRA's responses are set forth in detail below.

General Support and Opposition to the Notice 17-15 Proposal

Four commenters supported FINRA's efforts to simplify, clarify and modernize Rule 5110 but did not support all aspects of the Notice 17-15 Proposal.[97] SIFMA supported some aspects of the Notice 17-15 Proposal but suggested retooling Rule 5110 to a more disclosure-focused and principles-based approach. Callcott supported amending Rule 5110 to require only disclosure of financial relationships between a broker-dealer and its client in a securities underwriting. The remaining commenters expressed comments to several specific aspects of the Notice 17-15 Proposal as discussed below.

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Since 1992, Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in public offerings of securities. Rule 5110 continues to play an important role in ensuring investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

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96 See Exhibit 2b for a list of abbreviations assigned to commenters.

97 See ABA, NASAA, Rothwell and Sullivan.

The proposed rule change strikes an appropriate balance in modernizing Rule 5110 to allow for some flexibility where appropriate, while maintaining important protections. For instance, one area where FINRA is proposing to add some flexibility is to incorporate a limited principles-based approach to be used by FINRA in determining whether some securities acquisitions may be excluded from underwriting compensation. Specifically, the proposed rule change would incorporate a principles-based approach for acquisitions of securities in venture capital transactions where there has been a significantly delayed offering, acquisitions of issuer securities from third parties and acquisitions of securities pursuant to an issuer's directed sales program. The proposed rule change would retain Rule 5110's current objective approach for other securities acquisitions.

Callcott stated that Rule 5110's complexity imposes costs on all public underwritings and serves as an incentive to instead conduct private placements or other transactions. Moreover, Callcott stated that because "troubled" public companies present the highest liability risks for underwriters, underwriters are unwilling to assist those companies unless they are adequately compensated for the risk. Callcott suggests that Rule 5110 does not solve the problem of "small troubled" companies in need of financing; rather, Callcott states the Rule simply moves the problem to a largely non-transparent and unregulated alternative financial environment, to the significant detriment of companies and their investors.

The application of Rule 5110 to the receipt of underwriting compensation does not represent a material detriment to small firms or a disincentive to small firm IPOs. Rather, the decrease in small firm IPOs is a multi-faceted issue that may be caused by several factors (e.g., the availability of alternative financing or industry consolidation). Moreover, the availability of different sources of financing may be beneficial to some small firms. It is unclear how removing Rule 5110's restrictions on underwriting terms and arrangements, and corresponding restrictions on underwriting compensation, would be a net positive for "small troubled" companies in need of financing.

Filing Requirements

Three commenters supported allowing members more time to make the required filings with FINRA (from one business day after filing with the SEC or a state securities commission or similar state regulatory authority to three business days) and agreed that the change would help with logistical issues or inadvertent delays without impeding FINRA's ability to review the underwriting terms and arrangements.[98] ABA supported proposed Rule 5110(a)(4)(A)(ii) to expressly provide that standard industry forms are not required to be filed in connection with an offering, unless otherwise specifically requested by FINRA.

SIFMA suggested FINRA clarify that the requirement in proposed Rule 5110(a)(1)(B) that the managing underwriter notify the other members if the underwriting terms and arrangements are unfair and unreasonable and not appropriately modified be limited to situations where FINRA has made such determination with respect to the terms and arrangements and has so notified the managing underwriter. FINRA agrees and made the suggested change as discussed above in proposed Rule 5110(a)(1)(B).

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98 See ABA, ADISA and SIFMA.

ABA suggested that the Rule should permit reliance on filings made by issuers in proposed Rule 5110(a)(3)(B) or, alternatively, if not retained, the availability of such reliance should be clarified in Supplementary Material to Rule 5110. Participating members are responsible for filing the required documents and information with FINRA. 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 any documents and information as set forth in proposed Rule 5110(a)(4)(A) and (B) if specifically requested by FINRA regarding the takedown once the participating member has been engaged.

Commenters requested clarifying or deleting the Notice 17-15 Proposal's requirement to file amendments to any documents that contain "changes to the offering" in proposed Rule 5110(a)(4)(A)(iii) to narrow the filing requirement to changes relating to the disclosures made or to be made in any filing that impact the underwriting terms and arrangements for the offering.[99] The commenters suggested that narrowing the scope of proposed Rule 5110(a)(4)(A)(iii) would appropriately capture the documents relevant to FINRA's review and would reduce the burdens on members (and the associated time and cost) to make unnecessary administrative filings.

FINRA agrees with the commenters and proposes to narrow the filing requirement to changes that "impact the underwriting terms and arrangements for the public offering." Examples of changes impacting the underwriting terms and arrangements include, but are not limited to, changes to the size of the offering, the method of distribution (i.e., firm commitment or best efforts), the amount of underwriting

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[99] See ABA, ADISA, Davis Polk, Rothwell and SIFMA.

compensation, the type of underwriting compensation, and any new termination fee or ROFR that survives termination of the offering.

Two commenters supported the change in proposed Rule 5110(a)(4)(B)(iii) relating to the representation as to the association or affiliation between participating members and beneficial owners of 5 percent or more of "any class of the issuer's securities" to instead refer to beneficially owning 5 percent or more of any class of the issuer's "equity or equity-linked securities."[100] SIFMA also supported the proposed elimination of the requirement currently in Rule 5110 to provide a representation as to the association or affiliation between participating members and "any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering." SIFMA suggested that the narrower focus is appropriately designed to elicit the most useful information for reviewing relationships that may affect the underwriting terms and arrangements.

ABA requested guidance with respect to the representation requirement in proposed Rule 5110(a)(4)(B)(iii) where beneficial owners of 5 percent or more of any class of the issuer's equity securities are funds or other types of investment vehicles, which are usually in the form of limited partnerships or limited liability companies. ABA also requested that the representation be limited to a statement of association or affiliation only with respect to the general partner or investment manager of such fund or investment vehicle, and any limited partner beneficially owning more than 25 percent of the limited partnership or limited liability company membership interests of the fund or investment vehicle.

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[100] See ABA and SIFMA.

Although application of Rule 5110's requirements to beneficial ownership by funds or other types of investment vehicles historically has not been problematic, there have been some instances where conflicts have been identified. When questions have arisen related to beneficial ownership by funds or other types of investment vehicles, FINRA has been willing to work with members to address the questions raised by particular structures and arrangements. Rather than amending the Rule, FINRA proposes to retain the flexibility afforded by this established approach because beneficial ownership of 5 percent or more of an issuer's securities may result in conflicts of interest.

SIFMA suggested that proposed Rule 5110(a)(4)(B)(iv) – requiring the filing of a "description of any securities of the issuer acquired and beneficially owned by any participating member during the review period" – should be limited to a description of any securities-based underwriting compensation acquired during the review period by the participating member (i.e., no description for securities that do not constitute underwriting compensation). Limiting the description to securities that the participating member has determined would be underwriting compensation could result in an incomplete picture of the underwriting terms and arrangements. A description of any issuer securities acquired and beneficially owned by the participating member during the review period is needed to fully evaluate the underwriting terms and arrangements of the public offering and to ensure that there is no circumvention of the Rule.

While a complete description would be required, the proposed rule change provides flexibility with respect to whether some securities would be treated as underwriting compensation under Rule 5110. For example, because FINRA recognizes that some acquisitions of issuer securities from third parties are for purposes unconnected to underwriting compensation, the proposed rule change would incorporate a principles-based approach in considering whether securities of the issuer acquired from third parties may be excluded from underwriting compensation.

Given the strict limitations on the receipt of underwriting compensation in terminated offerings imposed by proposed Rule 5110(g)(5), SIFMA suggested deleting the requirement in proposed Rule 5110(a)(4)(C) for a member to file a written notification to FINRA of all underwriting compensation received or to be received pursuant to proposed Rule 5110(g)(5), including a copy of any agreement governing the arrangement if an offering is terminated. SIFMA suggested that at the very least, if the requirement is retained, the requirement should be limited to notice to FINRA with respect to the receipt of termination fees. ABA also did not support the requirement in proposed Rule 5110(a)(4)(C) and suggested that the lack of an end date for the requirement would lead to confusion. ABA suggested that, if the requirement is retained, FINRA should clarify the purpose of the obligation, confirm that any such payments are tied to the original failed offering and not a successful subsequent offering, and provide a sunset provision for the requirement.

FINRA believes that information regarding underwriting compensation received or to be received in terminated offerings is relevant to its evaluation of compliance with Rule 5110 and, in particular, paragraph (g)(5). Moreover, incorporating a sunset provision into proposed Rule 5110(a)(4)(C) could result in intentionally delaying payment of underwriting compensation until after the sunset date to circumvent the requirements of Rule 5110. Accordingly, the proposed rule change would retain the approach in the Notice 17-15 Proposal.

Davis Polk requested clarification regarding whether information relating to unvested securities acquired by participating members during the review period must be filed under Rule 5110. Davis Polk suggested that these securities should not constitute underwriting compensation, as it is unclear whether the conditions precedent to vesting will ever be satisfied. As noted above, it is important that FINRA have information on all securities received during the review period in order to more accurately evaluate the levels of underwriting compensation. When considering whether vested or unvested securities acquired by participating members and their associated persons are underwriting compensation FINRA evaluates why the securities were granted. For example, unvested directors' options granted to associated persons of participating members in excess of what other directors receive would be deemed underwriting compensation, but grants that are comparable to what other directors receive would not be underwriting compensation.

Filing Requirements for Shelf Offerings

SIFMA suggested modifying the exemption in proposed Rule 5110(h)(1)(C) to eliminate the requirement that issuers filing offerings on Form S-3 need to satisfy the pre-1992 Form S-3 standards or, alternatively, to provide a filing exemption for offerings by well-known seasoned issuers ("WKSIs") that meet current Form S-3 standards. Sullivan suggested exempting all offerings of securities registered on Forms S-3 and F-3 from both the Rule's substantive and filing requirements and, at a minimum, exempting WKSIs from Rule 5110. In light of established market practices, Sullivan believes that these issuers do not need FINRA's protection in the negotiation of underwriting terms and arrangements and that FINRA's oversight is an unnecessary speed bump to these issuers accessing the capital markets. Davis Polk questioned whether FINRA's goal of investor protection is furthered by the requirement to file WKSI offerings and suggested that FINRA's goal should be to make access to capital less expensive.

Given the availability of documents on the SEC's EDGAR system, Davis Polk suggested eliminating the requirement to file with FINRA prospectus supplements and underlying documents for shelf offerings subject to Rule 5110's filing requirements. Davis Polk suggested that member's counsel should instead be required, at the time of filing of the registration statement, to obtain representations from members that: (1) underwriting compensation will not exceed 8 percent of the gross offering proceeds; and (2) members will not engage in any prohibited arrangements in connection with any takedown from the base shelf registration statement.

As discussed in Item 3, given the regulatory issues that have previously arisen in shelf offerings, the proposed rule change would continue to apply Rule 5110's filing requirement to shelf offerings by issuers that do not meet the "experienced issuer" standard. However, to facilitate the ability of issuers to take advantage of favorable market conditions on short notice and to quickly raise capital through takedown offerings, the proposed rule change would streamline the filing requirements for shelf offerings by issuers that do not meet the "experienced issuer" standard. Specifically, with respect to these shelf offerings, the proposed rule change would provide that only the following documents and information must be filed: (1) the registration statement number; and (2) if specifically requested by FINRA, other documents and information set forth in proposed Rule 5110 (a)(4)(A) and (B).

FINRA would access the base shelf registration statement, amendments and prospectus supplements in the SEC's EDGAR system and populate the information necessary to conduct a review in the FINRA System. Upon filing of the required registration statement number and documents and information, if any, that FINRA requested pursuant to proposed Rule 5110(a)(4)(E), FINRA would provide the no objections opinion. To further facilitate issuers' ability to have quicker access to capital markets, FINRA's review of documents and information related to a shelf takedown offering for compliance with Rule 5110 would occur on a post-takedown basis.

Davis Polk suggested adding an exemption to the filing requirement for any offering on Forms S-3 and F-3 or any IPO: (1) of an issuer controlled by a venture capital or private equity fund with $100 million in assets under management; or (2) with proceeds of $75 million or more. Davis Polk stated that the filing requirement is not needed as these issuers are sophisticated professional negotiators and investors have immediate access to company disclosures through EDGAR, issuer websites and third party analysis. Alternatively, Davis Polk recommended that the proposed exemption for shelf offerings be revised to reflect, at a minimum, the Oct. 21, 1992 Form S-3 and F-3 eligibility requirement of a public float of $75 million or, preferably, to eliminate the public float requirement entirely, in accordance with current Form S-3 and F-3 standards. Davis Polk suggested that the requirement in the exemption that the issuer have reported under the Exchange Act for three years be modified to one year, as is the case with current Forms S-3 and F-3, on the grounds that a three year reporting history does not provide any benefit because technology provides investors with immediate access to information.

As discussed above, the proposed rule change would significantly reduce the filing obligations for shelf offerings. The underwriting terms and arrangements in IPOs of issuers controlled by venture capital or private equity funds or IPOs with proceeds of $75 million or more are not significantly different from those in other IPOs and FINRA's filing and review program is necessary for investor protection.

Exemptions from Filing and Substantive Requirements

Commenters suggested several changes to the proposed exemptions from Rule 5110's filing requirement or substantive provisions to expand, modify or clarify the exemptions. Three commenters recommended not subjecting to Rule 5110's filing requirement public offerings that otherwise meet a filing exemption but for participation by a QIU pursuant to Rule 5121.[101] The commenters suggested that subjecting these offerings to Rule 5110's filing requirement is unjustified and unwarranted, increases the issuer's transaction costs, and alters the composition of underwriting syndicates in ways that do not further investor or market protection.

Consistent with the approach in the current Rule, proposed Rule 5110(h)(1) would require filing these offerings only if there is participation by a QIU. Rule 5121 was amended in 2009 to focus on offerings with significant conflicts of interest that require the participation of a QIU.[102] FINRA has a regulatory interest in reviewing offerings in which a member has a significant conflict of interest requiring the participation of a QIU.

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101 See ABA, Davis Polk and SIFMA.

102 See Securities Exchange Act Release No. 60113 (June 15, 2009), 74 FR 29255 (June 19, 2009) (Order Approving File No. SR-FINRA-2007-009). See also Regulatory Notice 09-49 (August 2009).

Accordingly, filing and review of these offerings under Rule 5110 continues to be appropriate.

ABA requested revising the exemption from the filing requirement in proposed Rule 5110(h)(1)(E)(i) for exchange offers to include situations in which the securities to be acquired in the exchange are convertible into securities that are listed on a national securities exchange as defined in Section 6 of the Exchange Act. FINRA believes extension of the exemption to these convertible securities is unlikely to be problematic for market participants. Accordingly, the proposed rule change would expand proposed Rule 5110(h)(1)(E)(i) to exempt from the filing requirement exchange offers where the securities to be issued or the securities of the company being acquired are listed, or convertible into securities that are listed, on a national securities exchange as defined in Section 6 of the Exchange Act.

ABA suggested that in many cases the role played by a member acting as a distribution manager in connection with an exchange offer is limited to contacting investors and recording their intention to tender and that the member receives nominal compensation for these services. Accordingly, ABA requested exempting from Rule 5110's filing requirement exchange offers in which the compensation to be received by the distribution manager does not exceed 2 percent of the registered aggregate dollar amount of the offering and no member acts as an underwriter for the securities. Distribution managers may provide and receive compensation for a range of different services related to a public offering. Given this broad range of services, FINRA does not agree that providing an exemption from Rule 5110's provisions is appropriate based on the compensation for distribution manager-related services being less than the suggested threshold.

Davis Polk requested that an express exemption from Rule 5110's filing requirement be added for offerings of convertible debt of an issuer that has outstanding investment grade rated debt of the same class as that being offered if there is a bona fide public market in the common stock underlying the debt (i.e., the debt meets the exemption in proposed Rule 5110(h)(1)(B) and the underlying common stock generally meets the exemption in proposed Rule 5110(h)(1)(A)). FINRA has not received requests for an exemption for this type of convertible debt and, as such, the potential consequences of an express exemption in the current market environment are unclear. Exemptive relief from the filing requirement for this type of convertible debt may be available on a case-by-case basis as necessary and appropriate. To the extent that FINRA begins receiving numerous such requests, FINRA will evaluate whether an express exemption is warranted.

Davis Polk suggested that filing has not been previously required for shelf offerings registered for the benefit of selling shareholders that are intended to be sold in ordinary market transactions by members acting as agents (commonly called "dribble out offerings") and requested that an express exemption from the filing requirement be added to Rule 5110. Davis Polk also suggested an express exemption from the filing requirement for block trades in light of the highly competitive nature of negotiations between issuers and underwriters in connection with these offerings. Dribble out offerings and block trades are typically handled through shelf takedown offerings. As previously discussed, the proposed rule change would modify the requirements for shelf offerings to no longer require the filing of each takedown offering.

ABA stated that the proposed exemption in the Notice 17-15 Proposal from the filing requirement for follow-on offerings by qualifying tender offer funds should be extended to also cover IPOs by these entities. ABA requested that, if continued filing of IPOs by these issuers is required, Rule 5110 should be amended to provide that the underwriting terms and arrangements for these offerings, while subject to the filing requirements of Rule 5110, will be reviewed for compliance with the requirements of Rule 2341. As discussed in Item 3 supra, FINRA believes that it is appropriate to consider compensation for distribution of both IPOs and follow-on offerings of tender offer funds under the compensation limitations in Rule 2341. Accordingly, the proposed rule change would exempt both IPOs and follow-on offerings of tender offer funds from Rule 5110.[103]

As offerings of open-end funds and continuously offered interval funds and tender offer funds are exempted from Rule 5110, JLL suggested exempting offerings of continuously offered perpetual-life, publicly offered non-listed REITS ("PLRs") from the filing requirement. Open-end funds and continuously offered interval funds and tender offer funds are investment companies whose offerings can be appropriately regulated under the Investment Company Act; however, PLRs are generally exempt from the Investment Company Act. Because the protections of the Investment Company Act would not apply, the proposed rule change would not exempt PLRs from the filing requirement.

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103 See proposed Rule 5110(h)(2)(L).

ABA suggested that the exemption from Rule 5110's filing requirement for securities offered by issuers with qualifying debt securities be expanded to include offerings by issuers that are organized limited liability companies, limited partnerships, business trusts or other legal persons.[104] The Notice 17-15 Proposal would have replaced "corporate issuer" with "corporation" in this exemption. Rather than including a lengthy list of different types of legal persons, the proposed rule change would revert to the use of "corporate issuer." This approach, which is consistent with Rule 5110 currently, covers a broad range of legal entities that have qualifying debt securities and has not been problematic in practice.

CAI supported the proposed exemption in Rule 5110(h)(2)(E) from the filing and substantive requirements of Rule 5110 for "any insurance contracts not otherwise included" as appropriately resolving members' questions about the status of insurance contracts under FINRA rules. SIFMA also supported the addition of proposed exemptions from the filing and substantive requirements of Rule 5110 for insurance contracts[105] and unit investment trust securities.[106]

ABA requested clarification as to whether the exemption from the filing and substantive provisions of Rule 5110 for securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Company Utility Holding Company Act ("PUHCA") remains tied to that Act. The Energy Policy Act of

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104 See proposed Rule 5110(h)(1)(A).

105 See proposed Rule 5110(h)(2)(E).

106 See proposed Rule 5110(h)(2)(K).

2005 repealed the PUHCA Act of 1935 and adopted the PUHCA of 2005.[107] The exemption for any securities issued pursuant to any competitively bid underwriting arrangement meeting the requirements of the PUHCA continues to be appropriate. Accordingly, consistent with the current Rule, the proposed rule change would exempt from the filing and substantive requirements of Rule 5110 securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the PUHCA.[108]

Sullivan stated that all offerings of investment grade debt, preferred stock and other fixed-income securities should be exempt from Rule 5110's filing and substantive requirements. Sullivan stated that these offerings involve the tightest underwriting spreads and are intensely negotiated by issuers and, accordingly, the protections of Rule 5110 are not necessary for these offerings. Although some offerings of investment grade debt, preferred stock and other fixed-income securities are intensely negotiated by issuers, offerings of these securities have previously involved unreasonable and unfair underwriting terms and arrangements. Because Rule 5110 prohibits unreasonable and unfair underwriting terms and arrangements, it is appropriate for the Rule's protections to continue to apply to these offerings.

Disclosure of Underwriting Compensation

The Notice 17-15 Proposal would have no longer required that the disclosure include the dollar amount ascribed to each individual item of compensation. Instead the Notice 17-15 Proposal would have permitted a member to disclose the maximum aggregate amount of all underwriting compensation, except the discount or commission

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107 See Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

108 See proposed Rule 5110(h)(2)(H).

that must be disclosed on the cover page of the prospectus. The Notice 17-15 Proposal also included a requirement to disclose specified material terms and arrangements in the prospectus, which is consistent with current practice. A description would be required for: (1) any ROFR granted to a participating member and its duration; and (2) the material terms and arrangements of the securities acquired by the participating member (e.g., exercise terms, demand rights, piggyback registration rights and lock-up periods).[109]

Commenters expressed differing viewpoints on the proposed prospectus disclosure requirement changes in the Notice 17-15 Proposal. ADISA supported changing the disclosure requirements to require disclosure only of the aggregate amount of all compensation, other than discounts and commissions, in the prospectus. On the other hand, NASAA supported retaining the requirement in Rule 5110 for itemized underwriter compensation disclosure in the prospectus and did not support the proposed disclosure requirement changes in the Notice 17-15 Proposal. NASAA stated that itemized compensation: (1) allows investors to understand how money is being disbursed to underwriters; (2) provides investors with a better understanding of incentives underlying an underwritten public offering; and (3) provides investors additional liability protections for any misstatements in the disclosure. Davis Polk requested clarification as to the specific disclosure requirements for securities acquired by participating members that are deemed underwriting compensation.

As noted in Item 3 above, recognizing commenters' conflicting views, the proposed rule change would retain the current requirements for itemized disclosure of

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[109] See proposed Supplementary Material .05 to Rule 5110.

underwriting compensation.[110] The proposed rule change would make explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation, such as exercise terms, in the prospectus.[111]

Underwriting Compensation

While removal of Rule 5110's references to "items of value" was supported,[112] commenters requested several clarifications or changes to the proposed definition of underwriting compensation. Two commenters suggested that the reference to compensation received from "any source" in the proposed underwriting compensation definition was overly broad and should be deleted to instead focus on benefits received from or at the direction of the issuer.[113] Alternatively, if the phrase "any source" is not deleted, the commenters suggested that the definition should, at a minimum, be more narrowly tailored to address any specific concerns. Underwriting compensation typically is paid by the issuer, but FINRA has charged violations of its Corporate Financing Rules in connection with quid pro quo arrangements between underwriters and institutional investors for the allocation of hot issues that would make narrowing the source of compensation to issuers in all cases problematic.[114]

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110 See proposed Rule 5110(b)(1) and Supplementary Material .05 to Rule 5110. See also proposed Rule 5110(e)(1)(B) requiring disclosure of lock-ups.

111 See proposed Supplementary Material .05 to Rule 5110.

112 See SIFMA.

113 See Davis Polk and SIFMA.

114 See News Release, NASD, NASD Regulation Charges Credit Suisse First Boston with Siphoning Tens of Millions of Dollars of Customers' Profits in Exchange for "Hot" IPO Shares (January 22, 2002), http://www.finra.org/newsroom/2002/nasd-regulation-charges-credit-suisse-first-boston-siphoning-tens-millions-dollars. See also News Release, SEC, SEC Charges CSFB with Abusive IPO Allocation

Two commenters suggested revising the proposed underwriting compensation definition to provide that only payments made or securities received during the "review period" would be included in underwriting compensation.[115] In its reviews, FINRA typically only considers payments and benefits received during the applicable review period in evaluating underwriting compensation. However, if there is an arrangement, in fact, to pay compensation related to the underwriting outside the review period, the payment must be included under Rule 5110. Accordingly, the proposed rule change does not limit the proposed underwriting compensation definition to payments and benefits received during the review period.

SIFMA suggested deleting the last sentence of the proposed underwriting compensation definition, as that sentence would imply that finder's fees and underwriter's counsel fees are counted as compensation even if not reimbursed to the participating member. The approach in the proposed underwriting compensation definition is consistent with the treatment in the current Rule, which includes both finder's fees and underwriter's counsel fees as items of value.[116] The proposed rule change provides among the examples of payments that would be underwriting compensation: (1) fees and expenses of participating members' counsel paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement

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Practices CSFB Will Pay $100 Million to Settle SEC and NASD Actions; Millions in IPO Profits Extracted from Customers in Exchange for Allocations in "Hot" Deals (January 22. 2002), https://www.sec.gov/news/headlines/csfbipo.htm.

115 See Davis Polk and Rothwell.

116 See current Rule 5110(c)(3)(A)(iii)-(iv).

of "blue sky" fees); and (2) finder's fees paid or reimbursed to, or paid on behalf of, the participating members.[117]

Davis Polk suggested revising the proposed underwriting compensation definition to exclude securities of foreign (non-U.S.) issuers acquired by participating members in the issuer's domestic market if such market meets certain volume and float requirements. In determining whether the securities are underwriting compensation, Davis Polk suggested that considering whether the securities are traded on a "designated offshore securities market" (as defined in Rule 902(b) of SEC Regulation S) is overly restrictive and not meaningful; rather, the focus should be on whether the securities are freely trading so that the price paid is the fair market price. For this reason, Davis Polk also suggested that proposed Rule 5110(a)(4)(B)(iv) be modified so that participating members need not provide information regarding issuer securities they acquire during the review period in the issuer's domestic market.

The approach in the proposed rule change to provide that "listed securities" purchased in public market transactions would not be considered underwriting compensation is consistent with the treatment of these securities in the current Rule.[118] This treatment has not been historically problematic, with any issues related to securities of foreign (non-U.S.) issuers acquired by participating members in the issuer's domestic

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117 See proposed Supplementary Material .01(a)(3) and (4).

118 See proposed Supplementary Material .01(b)(11) to Rule 5110. Substantively consistent with the current Rule, proposed Supplementary Material .01(c)(1) to Rule 5110 would define listed securities to mean "securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S."

market arising infrequently. However, the integrity of foreign markets may vary significantly and information regarding shares obtained in those markets may be important to FINRA's review. While the proposed rule change does not propose to alter the treatment for these securities, exemptive relief may be available on a case-by-case basis as necessary and appropriate.

Davis Polk requested clarification as to whether fees and other compensation paid to foreign broker-dealers in connection with the foreign (non-U.S.) distribution of the offering should be deemed underwriting compensation. Rule 5110 does not apply to fees and other compensation paid to underwriters for securities distributions made exclusively in foreign markets. Notwithstanding that some shares may be sold in foreign markets global offerings typically register shares in the U.S. to accommodate the potential for flow back in the U.S. At the time of FINRA's review, the exact amount of shares that will be sold in the U.S. is not available. Therefore, FINRA's initial review is based on the entire amount registered.

Two commenters suggested that the lack of an express public standard for determining when the aggregate amount of proposed underwriting compensation is unfair and unreasonable under Rule 5110 has caused confusion on the part of issuers, underwriters and counsel.[119] 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, as well as all other relevant facts and circumstances: (1) the anticipated maximum amount of offering

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119 See EGS and Rothwell.

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.[120]

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.

Examples of Payments or Benefits that Are or Are Not Considered Underwriting Compensation

Commenters requested clarification or expansion of the proposed non-exhaustive lists of examples of payments or benefits that would be and would not be considered underwriting compensation. SIFMA suggested that the prefatory language to proposed Supplementary Material .01(a) should state "[t]he following are examples of payments or benefits that are considered underwriting compensation 'if received during the review period for underwriting, allocation, distribution, advisory or other investment banking services provided in connection with the public offering.'" The proposed rule change does not include a reference to the review period in the prefatory language. As discussed above, if there is an arrangement, in fact, to provide payments or benefits for

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[120] These factors are set forth in current Rule 5110(c)(2)(D). Because this guidance is more appropriate for a Regulatory Notice than rule text, the proposed rule change would eliminate the factors in the current Rule. However, FINRA will consider whether additional discussion of this topic in a Regulatory Notice or frequently asked questions would be helpful.

underwriting services outside the review period, the payments or benefits must be included under Rule 5110. Moreover, because the proposed definition of underwriting compensation already refers to underwriting, allocation, distribution, advisory or other investment banking services provided in connection with a public offering, it is unclear how adding the language to the lists of examples would be helpful.

Two commenters suggested that the items in proposed Supplementary Material .01(a)(3) and (4) to Rule 5110 be revised to clarify that such items (i.e., finder's fees and counsel fees) are counted as underwriting compensation solely to the extent they are reimbursed to, or paid on behalf of, the participating members.[121] This is consistent with the approach in proposed Supplementary Material .01(a)(2) to Rule 5110 for other fees and expenses, including, but not limited to, road show fees and expenses and due diligence expenses. Accordingly, FINRA made the suggested change.

SIFMA suggested that proposed Supplementary Material .01(a)(7) to Rule 5110 be revised to provide that common stock and other equity securities would not be considered underwriting compensation if purchased or acquired in a transaction that complies with proposed Rule 5110(d) or is otherwise excluded as underwriting compensation pursuant to other provisions of the proposed Rule (including Supplementary Material .01(b) to Rule 5110). The list of examples of underwriting compensation in proposed Supplementary Material .01(a) to Rule 5110 is intended to be read in combination with the venture capital exceptions and list of examples of what would not be considered underwriting compensation. The proposed rule change does not incorporate the suggested change because it is unclear how adding cross-references to

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121 See ABA and SIFMA.

Supplementary Material .01(a)(7) to Rule 5110 would be beneficial. Rather, adding the cross-reference to one example of underwriting compensation as suggested would seem to add confusion, not clarity, to the Rule's requirements.

SIFMA suggested that proposed Supplementary Material .01(a)(9) to Rule 5110 be revised to eliminate the one percent valuation assigned to ROFRs. SIFMA suggested that ROFRs be deemed underwriting compensation but be assigned zero compensation value (unless the agreement in which the ROFR is granted contains a dollar amount contractually agreed to by the parties to waive the ROFR, in which case that amount should be included). ROFRs have historically been assigned a one percent valuation for purposes of Rule 5110. FINRA continues to believe that ROFRs are a valuable benefit that traditionally have been used in combination with other forms of compensation to reward underwriters and that this historical approach to valuing ROFRs is reasonable.

SIFMA acknowledged that proposed Supplementary Material .01(a)(13) to Rule 5110 – which provides that any compensation paid to any participating member in connection with a prior proposed public offering that was not completed is considered underwriting compensation, if the member participated in the revised public offering – is consistent with the current Rule. However, SIFMA questioned the rationale for the treatment of this compensation if it was received in accordance with proposed Rule 5110(g)(5) – which sets forth the requirements for termination fees. SIFMA suggested that proposed Supplementary Material .01(a)(13) to Rule 5110 should make it clear that the prior compensation would be treated as underwriting compensation only if it is received within the review period for the new public offering.

Rule 5110's termination provisions were revised in 2014 to provide members with greater flexibility in negotiating the terms of their agreements for terminated offerings, while also providing protection for issuers if a member fails materially to perform the underwriting services contemplated in the written agreement.[122] The proposed Supplementary Material, which is consistent with the current Rule, continues to fulfill this purpose. Furthermore, the compensation received in a prior terminated offering would be considered underwriting compensation under Rule 5110 only if the member participates in the revised public offering.

With respect to proposed Supplementary Material .01(a)(14) to Rule 5110, SIFMA stated that gifts and business entertainment provided in compliance with the limits set forth in proposed Rule 5110(f)(2)(A) and (B) (which allow for nominal gifts and occasional meals, sporting events or comparable entertainment) should not be counted as underwriting compensation as there is no rationale and investor protection goal served by the imposition of this requirement. Non-cash compensation, including gifts and business entertainment, in connection with a public offering may be reasonably considered underwriting compensation. To the extent that any gifts and business entertainment are provided in compliance with the limits set forth in proposed Rule 5110(f)(2)(A) and (B), the amount of underwriting compensation attributable to the gifts and business entertainment should not be significant in practice. With that said, FINRA is currently reviewing all of its non-cash compensation provisions in the context of a separate retrospective rule review.[123]

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122 See Securities Exchange Act Release No. 72114 (May 7, 2014), 79 FR 27355 (May 13, 2014) (Order Approving File No. SR-FINRA-2014-004).

123 See Regulatory Notice 16-29 (August 2016).

Davis Polk noted that proposed Supplementary Material .01(b)(1) provides that fees of "independent financial advisers" would not be underwriting compensation but questioned the treatment of fees paid to members for acting solely as "financial advisers." The proposed rule change would define an independent financial adviser consistent with the current Rule.[124] Application of the Rule to financial advisers was addressed when the defined term independent financial adviser was added to Rule 5110 in 2014.[125] The application of the Rule to fees paid to financial advisers and the carve-out for fees of independent financial advisers, as that term is defined, continues to be appropriate.

SIFMA suggested that proposed Supplementary Material .01(b)(2) to Rule 5110 should exclude from underwriting compensation "cash compensation received for providing services in a private placement," rather than being limited to acting as a placement agent. SIFMA stated that limiting the provision to receipt of cash compensation solely for acting in a placement agent capacity is unnecessarily narrow and should be removed. Rule 5110 currently provides that cash compensation received for acting only as a private placement agent would not be an item of value. Member's roles in acting as a placement agent and in providing services in a private placement similarly facilitate offerings. Upon further review, FINRA agrees that this carve-out can be expanded to include the provision of other services by a member for a private placement without the risk of harm to investors. Accordingly, the proposed rule change would

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[124] See current Rule 5110(a)(5)(B) and proposed Rule 5110(j)(9).

[125] See Securities Exchange Act Release No. 71372 (January 23, 2014), 79 FR 4793 (January 29, 2014) (Notice of Filing of File No. SR-FINRA-2014-003). See also Letter from Kathryn M. Moore, Associate General Counsel, FINRA, to Kevin O'Neill, Deputy Secretary, SEC, (regarding File No. SR-FINRA-2014-003), dated April 16, 2014.

expand the scope of proposed Supplementary Material .01(b)(2) to Rule 5110 to include cash compensation for providing services for a private placement.

Two commenters suggested that proposed Supplementary Material .01(b)(11) to Rule 5110 should be modified to remove the reference to “listed” securities (i.e., all securities purchased in public market transactions should be excluded from underwriting compensation, regardless of whether they are listed).[126] The proposed approach is consistent with the treatment in Rule 5110 currently, which provides that listed securities acquired in public market transactions would not be an item of value.[127] The defined term “listed securities” in Supplementary Material .01(c)(1) of Rule 5110 provides greater clarity on the scope of covered securities than the commenters’ suggestion.

Three commenters suggested amending proposed Supplementary Material .01(b)(12) to Rule 5110 to expressly provide that securities received by directors or employees under any written compensatory benefit plan would not be underwriting compensation.[128] The commenters stated that these types of plans are for the purpose of compensating directors and employees and are unrelated to underwriting compensation in connection with a public offering. FINRA would interpret the reference to a “similar plan” in proposed Supplementary Material .01(b)(12) to Rule 5110 to include a written compensatory benefit plan for directors and employees that provides comparable grants of securities to similarly situated persons (e.g., a written compensatory benefit plan that provides comparable grants of securities to all qualifying employees) and accordingly

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126 See ABA and SIFMA.

127 See current Rule 5110(c)(3)(B)(iii).

128 See ABA, Davis Polk and Rothwell.

does not propose to change the Rule text. A "similar plan" would not include a compensatory benefit plan that was developed or structured to circumvent the requirements of Rule 5110.

SIFMA suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include any cash compensation, securities or other benefit received by a person who was not, at the time of the acquisition of the compensation, an associated person, immediate family or affiliate of a participating FINRA member. Because persons have previously transferred from issuers to members around the time of securities acquisitions, the proposed rule change would not provide an express carve-out provision as suggested. However, exemptive relief may be available for bona fide transfers on a case-by-case basis as necessary and appropriate.

SIFMA suggested amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include any cash compensation, securities or other benefit received by an associated person, immediate family or affiliate of a participating member if the member or its parent or other affiliate is issuing its own securities in the public offering. Because a broad carve-out could be used to circumvent the requirements of Rule 5110, the proposed rule change would not provide an express provision as suggested. Exemptive relief may be available on a case-by-case basis as necessary and appropriate where a participating member or its parent or other affiliate is issuing its own securities in the public offering.

Several commenters suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization. Specifically, SIFMA suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include acquisitions of securities before or after the required filing date by participating members pursuant to a U.S. or non-U.S. governmental or court-approved proceeding or plan of reorganization in which new securities are issued to or are available for purchase by existing securities holders (e.g., a bankruptcy or tax court proceeding) where such participating members receive or purchase such securities on the same terms as other similarly-situated security holders. ABA supported amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities acquired by a participating member in connection with a court-approved bankruptcy process. In addition, Davis Polk supported amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities issued pursuant to court order.

Because these securities acquisitions would be overseen by the government or court, the risk of intentional circumvention of Rule 5110 or investor harm is minimized. Accordingly, the proposed rule change would provide that underwriting compensation would not include securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding).[129]

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[129] See proposed Supplementary Material .01(b)(22) to Rule 5110.

Venture Capital Exceptions from Underwriting Compensation

SIFMA requested that FINRA state affirmatively that Rule 5110's venture capital exceptions are non-exclusive safe harbors and that other securities acquisitions that do not meet one of the express safe harbors (or fall within other exceptions provided elsewhere in Rule 5110) would also be excluded from characterization as underwriting compensation (and the accompanying lock-up restrictions) if the acquisition of the securities by the participating member is not compensation for providing underwriting, allocation, distribution, advisory or other investment banking services in connection with the public offering. FINRA proposes to retain an objective standard for distinguishing securities acquired in bona fide venture capital transactions from those acquired as underwriting compensation. While retaining this objective standard, the proposed rule change provides additional flexibility for members via the principles-based approach for significantly delayed offerings or the examples in proposed Supplementary Material .01(b) in some securities acquisitions not being underwriting compensation.

ABA generally supported the proposed changes to the venture capital exceptions but suggested that some additional changes be considered. Specifically, ABA suggested that the requirement that the participating member must acquire the issuer's securities "at the same price and with the same terms as securities purchased by all other investors" be revised such that the participating member may acquire its securities "on no better terms" than the other investors. ABA noted that members may choose to forego voting rights or other indicia of control when purchasing an issuer's securities and this detrimental variation in the purchase terms should not deny a participating member the ability to rely on the exceptions.

Introducing the concept of securities acquisitions "on no better terms" would introduce considerable uncertainty into the evaluation of whether any of the venture capital exceptions would be available. The "on no better terms" concept would require a weighing and consideration of all of the various terms of a securities acquisition, which could be time consuming for members, counsel and FINRA staff. Retaining the concept of "at the same price and with the same terms," which is in the current Rule, provides objectivity and clarity.

ABA also requested revising proposed Rule 5110(d)(1)(B) to read "investment or loan" rather than "investment and loan" to make clear that the provision does not require a participating member or its affiliate to make both an investment in and a loan to the issuer in order to rely on the exception. To clarify that both an investment in and a loan to the issuer are not required, the proposed rule change would revert to the current use of "or" in current Rule 5110(d)(5)(A)(i)c.[130]

Two commenters supported amending the timing requirement for the venture capital exceptions to allow for application to situations in which the participating member or its affiliate has made its investment in the issuer after the required filing date.[131] If not so amended, SIFMA suggested either: (1) eliminating the pre-filing timing restriction in proposed (d)(1) and (2), which address securities acquired by certain affiliates of a participating member; or (2) establishing for all of these exceptions a formal mechanism to reset the required filing date for significantly delayed offerings.

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130 See proposed Rule 5110(d)(1)(B).

131 See ABA and SIFMA.

When an offering has been significantly delayed, FINRA would consider the factors in proposed Supplementary Material .02 to Rule 5110 discussed above to analyze whether securities acquired in a transaction that occurs after the required filing date, but otherwise meets the requirements of a venture capital exception, may be excluded from underwriting compensation.

SIFMA suggested that the venture capital exceptions be amended to provide that the determination as to the availability of an exception is to be made by the participating member at the time of the acquisition of the securities and on the basis of the information then known to the participating member. Except for the principles-based approach for significantly delayed offerings, the venture capital exceptions apply to the acquisition of securities before the required filing date. Accordingly, whether an acquisition of the securities meets an exception must be determined before the required filing date.

NASAA expressed concern about removing the restriction in current Rule 5110(d)(5)(A) and (B) that the exception from underwriting compensation is available only to underwriters and their affiliates who own less than 25 percent of the issuer's total equity, as the removal of the restriction may increase the potential for conflicts of interest to arise. NASAA questioned whether the proposed changes further investor protection and whether the protections of Rule 5121 are adequate. FINRA believes, however, the proposed rule change would eliminate an unnecessary restriction in the relevant venture capital exceptions. Post-2004 regulatory changes in other areas, such as the 2009 revision of Rule 5121 regarding public offerings with a conflict of interest, have added protections to address acquisitions that create control relationships. Moreover, in FINRA's experience control transactions that result in ownership of more than 25 percent of an issuer involve significant investment risks and are not designed to be a means to obtain additional underwriting compensation.

SIFMA stated that the addition of "through a subsidiary it controls" in the venture capital exceptions in proposed Rule 5110(d)(1) and (2) is a useful clarification, but suggested that provision be modified to require that "the affiliate is 'or will be' primarily engaged in the business of making investments in or loans to other companies, 'or has been formed for the purpose of making this investment or loan by a parent that is directly or indirectly engaged in such activities.'" SIFMA suggested that this modification would address situations in which the investing entity is a newly formed vehicle and does not, outside the present investment, have a history of making such investments in other companies.

Expanding the scope of the exceptions to cover direct, indirect or newly formed entities that are in the business of making investments and loans acknowledges the different structures that may be used to participate in bona fide venture capital transactions. Expanding these exceptions to cover entities that may be formed in the future could undermine the protection that results from requiring an entity to be in the business of making such acquisitions, rather than one simply formed to participate in a compensation transaction.

SIFMA supported increasing the participating members' aggregate acquisition threshold from 20 percent to 40 percent of the total offering in the venture capital exception in proposed Rule 5110(d)(3). SIFMA suggested, however, that limiting this venture capital exception to receipt of the securities for placement agent activities is too narrow and should be removed (e.g., securities-related compensation could be offered by an issuer in return for advisory or other services provided by a participating member in connection with the private placement, rather than for services as a placement agent).

FINRA believes that the venture capital exception in proposed Rule 5110(d)(3) can be expanded to include the provision of other services for a private placement without the risk of harm to investors. Accordingly, the proposed rule change would expand the scope of proposed Rule 5110(d)(3) to include providing services for a private placement (rather than just acting as a placement agent). Proposed Rule 5110(d)(3) would also be clarified to refer to 51 percent of the "total number of securities sold in the private placement." The current rule text states "at least 51 percent of the 'total offering' (comprised of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member)."

SIFMA also suggested adding another venture capital exception from underwriting compensation for securities acquired before or after the required filing date by a participating member in connection with a loan or a private placement in which securities (at the same price and with the same terms) were also acquired by certain types of special investors, including: (1) registered investment companies; (2) a fund or insurance company that meets the qualifications in proposed paragraph (d)(1), (2) or (3); (3) a publicly traded company that is listed on a national securities exchange or a non-U.S. issuer that meets the quantitative designation criteria for listing on a national securities exchange; (4) a benefit plan qualified under Section 401(a) of the Internal Revenue Code (provided that such plan is not sponsored by the participating member); (5) a state or municipality, or a state or municipal government benefits plan that is subject to state and/or municipal registration; (6) a sovereign wealth fund or similar investment vehicle; (7) a bank as defined in Section 3(a)(6) of the Exchange Act; or (8) an organization described in Rule 15a-6(a)(4)(ii), provided no participating member manages such entity's investments or otherwise controls of directs the management or policies of such entity and such entity or entities acquire in the aggregate at least 10 percent of the total offering.

Providing the suggested venture capital exception could result in a significant expansion of the historical scope of Rule 5110's venture capital exceptions, as the identified special investors represent much of the traditional pool of pre-IPO investors. Providing such a broad exception, without requirements comparable to those imposed by the other exceptions, could result in most securities acquisitions by participating members before the required filing date being excepted from underwriting compensation. However, a participating member may make a co-investment in an issuer in circumstances that do not fit the conditions for the current venture capital exceptions. Where a highly regulated entity with significant disclosure requirements and independent directors who monitor investments is also making a significant co-investment in the issuer and is receiving securities at the same price and on the same terms as the participating member, the securities acquired by the participating member in a private placement are less likely to be underwriting compensation.

To address such co-investments, the proposed rule change would adopt a new venture capital exception from underwriting compensation for securities acquired in a private placement before the required filing date of the public offering by a participating member if at least 15 percent of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that are open-end investment companies not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering. These conditions lessen the risk that the co-investment would be made for the purpose of the participating member avoiding the requirements of Rule 5110.

Treatment of Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

Commenters requested clarifications and modifications to the treatment of non-convertible or non-exchangeable debt securities and derivatives. Rothwell stated that non-convertible or non-exchangeable debt securities should not be underwriting compensation, regardless of whether the securities were acquired in a transaction related to the offering, as they are unlikely to be used as a payment for investment banking services. If these debt securities continue to be treated as underwriting compensation, Rothwell recommended adopting a narrower exception from underwriting compensation for these debt securities issued at par (if the purchaser is the sole purchaser) or purchased at least at the same price as other purchasers at or about the same time for the same issue of debt. Rothwell stated there would be no investor protection benefit to including such securities in underwriting compensation. Rothwell suggested that this valuation method would provide an objective methodology that is appropriate to these debt securities and is consistent with investor protection.

SIFMA stated that non-convertible or non-exchangeable debt securities and derivative instruments that are acquired or entered into at a fair price in a transaction related to a public offering should not be considered underwriting compensation. However, SIFMA suggested that such arrangements should continue to be disclosed in the prospectus because they are entered into in transactions related to the public offering.

As a secondary option, SIFMA suggested that proposed Supplementary Material .06 to Rule 5110 be modified to provide that: (1) "non-convertible or non-exchangeable debt securities and derivative instruments acquired 'from or entered into with the issuer' in a transaction related to the public offering and at a fair price will be considered underwriting compensation but will have no compensation value"; and (2) any securities or other payment received by a participating member during the review period in connection with the settlement or termination of a derivative instrument that was entered into at a fair price in a transaction related to the public offering will, like the derivative instrument itself, have no compensation value. SIFMA further commented that if the suggested change is not made, proposed Rule 5110(g)(8), which prohibits certain terms in connection with "the receipt of underwriting compensation consisting of any option, warrant or convertible security," should be modified to exclude fair price derivatives.

Because "related to the offering" is not defined, Davis Polk suggested that the test of whether the non-convertible or non-exchangeable debt and derivative instruments were acquired at a fair price provides a more meaningful standard. Rothwell stated that the terms "related to the public offering" and "unrelated to the public offering" as used in the Rule are confusing and that it would be more appropriate to treat securities as underwriting compensation if not acquired at a fair price or to apply the standards in the definition of "underwriting compensation."

Rule 5110 distinguishes between whether the non-convertible or non-exchangeable debt securities and derivative instruments were acquired in a transaction related or unrelated to a public offering. The proposed rule change would clarify that non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction unrelated to a public offering would not be underwriting compensation. Consistent with the current Rule, these debt securities and derivative instruments would not be subject to Rule 5110 (i.e., a description of the debt securities and derivative instruments need not be filed with FINRA, there are no valuation-related requirements and the lock-up restriction does not apply).

In contrast, non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to a public offering would be underwriting compensation and a description of these debt securities or derivative instruments must be filed with FINRA. The proposed rule change would clarify that these debt securities and derivative instruments acquired at a fair price would be considered underwriting compensation but would have no compensation value, while these debt securities and derivative instruments acquired not at a fair price would be considered underwriting compensation and subject to the normal valuation requirements of Rule 5110.

SIFMA also suggested the definition of fair price be revised to clarify that securities or instruments that are intended to be compensatory in nature for acting as a private placement agent for the issuer, for providing a loan, credit facility, merger, acquisition or any other service, including underwriting services, would not be viewed as having been acquired or entered into at a fair price, otherwise the reference to "any other service" could be read broadly as to render the definition meaningless. To clarify the scope of the definition, the proposed rule change would provide that a "derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price."[132]

Lock-Up Restrictions

Commenters requested several changes to the lock-up restriction, including the length of and securities subject to the restriction. Some commenters agreed that a 180-day lock-up period would be appropriate for IPOs but recommended a shorter (e.g., 30- to 45-day) lock-up period for follow-on offerings.[133] SIFMA also suggested that the lock-up requirement not apply in connection with offerings of securities that have a bona fide public market (as that term is defined in Rule 5121).

In contrast, NASAA noted that the NASAA Promotional Shares Statement of Policy requires a lock-up period that is much longer than 180 days (i.e., that promotional shares that are not fully paid will be subject to a lock-up agreement for at least one or two years following the completion of the offering) to ensure that investors and promoters assume similar risks in the offering. Consequently, NASAA urged requiring a longer lock-up period under Rule 5110 to more closely align the interests of the underwriters with those of the investors in the offering.

The proposed rule change continues the historical approach of a 180-day lock-up period for both initial and follow-on public offerings. While the insider lock-up period could be less than 180 days in a follow-on offering, the insider lock-up period is commonly 180 days in IPOs. Keeping the same lock-up period for underwriters and the issuer's insiders provides equivalent protections for the secondary market. While the

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[132] See proposed Supplementary Material .06(b) to Rule 5110.

[133] See ADISA, Rothwell and SIFMA.

insider lock-period may vary among follow-on offerings, a consistent 180-day lock-up period for underwriters ensures that they do not accept less investment risk than insiders subject to a 180-day lock-up period.

ABA commended FINRA for revising the lock-up restrictions under proposed Rule 5110(e)(1) to clarify that the 180-day restricted period begins with the date of commencement of sales in the public offering and to minimize the impact of the lock-up restriction by including some important additional exemptions. NASAA supported the lock-up restriction being determined by the date of commencement of sales in the public offering (rather than from the date of effectiveness) and suggested that this change would provide increased protection for investors. However, ADISA suggested that the lock-up restriction should be determined using the date of effectiveness to provide clarity to all participants as the term "commencement of sales" can be vaguer and harder to determine rather than the definitive date of effectiveness.

Because the approach in the Notice 17-15 Proposal provides clarity in measuring the lock-up period, particularly with respect to securities sold pursuant to a registration statement or amendment thereto that does not have to be declared effective by the SEC, the proposed rule change retains the approach that the lock-up restriction is determined by the date of commencement of sales in the public offering (rather than from the date of effectiveness).

ABA stated that the lock-up restriction should apply only to equity securities received in transactions that are not registered with the SEC and that the lock-up restriction in the Notice 17-15 Proposal would potentially expand the scope of the lock-up restriction to include all public offerings. Rothwell stated that the lock-up restriction should apply only to securities deemed underwriting compensation in the case of public offerings of equity securities. Rothwell suggested revising the lock-up restriction to state that the restriction applies only in the case of a public equity offering of common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered.

The Notice 17-15 Proposal provided a broad lock-up requirement with several delineated exceptions. FINRA agrees that the scope of the lock-up requirement should be "public equity offering" as is used in the current Rule. The proposed rule change simplifies, clarifies and reduces the securities considered underwriting compensation and thus subject to the lock-up restriction. To the extent that securities are underwriting compensation and subject to lock-up restriction, exemptive relief may be available on a case-by-case basis as necessary and appropriate.

ABA requested guidance with respect to whether it is intended that the lock-up restriction would prevent participating members from selling securities acquired as underwriting compensation in the public offering itself. The proposed rule change would add an exception from the lock-up restriction for securities that were received as underwriting compensation, and are registered and sold as part of a firm commitment offering.[134] This is intended to give some flexibility to members in selling securities received as underwriting compensation, while limiting the proposed exception to firm commitment offerings where the underwriter has assumed the risk of marketing and distributing an offering that includes securities the underwriter received as underwriting

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[134] See proposed Rule 5110(e)(2)(A)(viii).

compensation. In addition, firm commitment offerings are usually marketed and sold to institutional investors, who typically purchase a majority of the shares in such offerings.

SIFMA stated that the Notice 17-15 Proposal appeared to subject non-convertible or non-exchangeable debt securities and derivative instruments acquired at a fair price in a transaction related to the offering and non-listed securities of an issuer acquired in a public market transaction to Rule 5110's lock-up restriction, unless the security is of an issuer that meets the registration requirements of current Forms S-3, F-3, F-10 (for brevity, referred to herein as "current eligible issuers"). SIFMA supported the exception for current eligible issuers, but stated that the lock-up restriction should apply only to public offerings of equity and equity-linked securities, should cover only equity and equity-linked securities received as underwriting compensation by participating members in offerings not registered under the Securities Act and should provide an express exception for fair price derivatives. Moreover, SIFMA suggested that the proposed exception for current eligible issuers should be clarified to expressly provide that the exclusion also applies to derivative instruments entered into with such issuers.

Davis Polk stated that application of the lock-up restriction to non-convertible or non-exchangeable debt securities and derivative instruments is not justified and may interfere with some derivative transactions. Rothwell suggested that non-convertible or non-exchangeable debt securities deemed to be underwriting compensation should be excluded from the lock-up restriction as there is no investor protection benefit to be received. Rothwell stated that these securities that are included in the calculation of underwriting compensation: (1) are likely a different issue or series than those sold to the public and will not have a public market; and (2) even if the securities are from the same issue, the public secondary market trading price of such debt securities is primarily determined by fluctuating interest rates rather than the types of market forces that affect the equity markets.

The proposed rule change would provide clarity about the treatment of non-convertible or non-exchangeable debt securities and derivative instruments acquired in transactions related to a public offering. The proposed rule change would retain the current approach for non-convertible or non-exchangeable debt securities acquired in a transaction related to the public offering and would provide an express exception from the lock-up restriction for clarity (i.e., the exception would provide that the lock-up restriction does not apply).[135]

However, derivative instruments are currently subject to Rule 5110's lock-up restriction. FINRA recognizes that members may acquire derivative instruments in connection with a hedging transaction related to the public offering and that, given the nature of these hedging transactions, the lock-up restriction should not apply. Accordingly, the proposed rule change would provide that the lock-up restriction does not apply to derivative instruments acquired in connection with a hedging transaction related to the public offering and at a fair price.[136] Derivative instruments acquired in transactions related to the public offering that do not meet the requirements of the exception would be subject to the lock-up restriction.

SIFMA suggested expressly excluding from the lock-up restriction any securities received in connection with the settlement or termination of a derivative instrument

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[135] See proposed Rule 5110(e)(2)(A)(iv).

[136] See proposed Rule 5110(e)(2)(A)(v).

received outside the review period or during the review period in a transaction unrelated to the public offering, such as by revising proposed Supplementary Material .01(b)(14) to Rule 5110 to read "securities acquired as the result of a conversion 'or exchange' of securities originally acquired prior to the review period and securities acquired at termination or in settlement of a derivative instrument entered into prior to the review period or during the review period in a transaction unrelated to the public offering." The lock-up restriction would not apply to securities that were acquired in a transaction unrelated to the public offering. However, because an "exchange" could relate to a wholly different transaction, the suggested revision to proposed Supplementary Material may be overly broad.

SIFMA suggested that the one percent threshold in proposed Rule 5110(e)(2)(A)(ii) – which provides that the lock-up restrictions will not apply if the aggregate amount of securities of the issuer beneficially owned by a participating member does not exceed one percent of the securities being offered – should be tied to the amount of securities received as underwriting compensation during the review period rather than more broadly to all securities held by the participating member. Accordingly, SIFMA suggested that the lock-up restriction should not apply to securities received during the review period as underwriting compensation if the amount of such securities does not exceed one percent of the securities being offered in the public offering. FINRA believes that the aggregate amount of securities beneficially owned by a participating member is a better measure of the potential impact of sales by the participating member into the secondary market.

SIFMA suggested that the exception in proposed Rule 5110(e)(2)(A)(vii) should be modified to allow for the sale or other disposition of the securities by registered investment advisers, even if such advisers are affiliated with a participating FINRA member. To accomplish this change, SIFMA suggested revising proposed Rule 5110(e)(2)(A)(vii) to state "the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that (a) no participating member '(other than a participating member that is registered as an investment adviser under the U.S. Investment Advisers Act of 1940 and is acting in accordance with its responsibilities thereunder)' manages or otherwise directs investments by the fund, and (b) participating members in the aggregate do not own more than 10 percent of the equity of the fund." SIFMA stated that participating members registered as investment advisers are separately regulated and have a fiduciary duty to act in the best interests of their clients, and the lock-up restriction may interfere with that regulatory responsibility. FINRA believes that this lock-up exception continues to be appropriate to securities received as underwriting compensation by a fund controlled by a participating member.

Defined Terms

The Notice 17-15 Proposal definition of "public offering" was based on the definition in Rule 5121, but included the delineated carve-outs in the Rule 5121 definition (which relate to certain types of securities offerings that are commonly understood not to constitute offerings to the public) separately in the list of securities offerings exempted from Rule 5110's filing and substantive requirements. The practical effect of this approach was that the carve-outs in Rule 5121 (e.g., securities exempt from registration under Securities Act Rule 144A or Regulation S) would not be subject to the filing or substantive provisions of Rule 5110.

Two commenters stated that the definition of public offering proposed in Notice 17-15 eliminated the carve-outs currently in the Rule 5121 definition of public offering, thus substantially broadening the definition.[137] The commenters requested a definition of public offering be adopted that retains the carve-outs with the definition, as such offerings would already be exempt from the Rule's coverage by virtue of the definition of public offering itself. Because the approach in the Notice 17-15 Proposal raised questions regarding the intended scope of the public offering definition, the proposed rule change incorporates the public offering definition from Rule 5121, accompanied by the delineated carve-outs, and correspondingly deletes those carve-outs from the proposed list of exemptions from the filing and substantive provisions of Rule 5110.[138]

ABA recommended revising the public offering definition to state "any primary or secondary distribution of securities 'made in whole or in part in the United States' 'to the public.'" ABA suggested that this approach would avoid circularity and more accurately reflect the types of offerings intended to be covered by the Rule. To clarify the jurisdictional scope, the proposed rule change would include "in whole or in part in the United States" in the public offering definition. However, because the addition of "to the public" may raise new questions on the scope of covered offerings, the proposed definition does not include that language.

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137 See ABA and SIFMA.

138 See proposed Rule 5110(j)(18).

SIFMA suggested that because the defined term "experienced issuer" differs from the terminology used by the SEC for purposes of Form S-3, the term is likely to lead to confusion. Beyond the name, commenters suggested modifying the definition substantively. Specifically, SIFMA suggested that the definition mean: "an issuer that (i) meets the registrant requirements specified in paragraph I.A of SEC Form S-3, except that for purposes of paragraph I.A.3 thereof, the reference to twelve calendar months shall be deemed to refer instead to 36 calendar months; and (ii) has an aggregate market value of outstanding voting and non-voting common equity held by non-affiliates (as calculated pursuant to General Instruction I.B.1 of Form S-3) of (a) at least U.S. $150 million or (b) at least U.S. $100 million and the issuer has had an annual trading volume of its common equity of at least three million shares (or share equivalent)." Sullivan suggested that, at a minimum, the experienced issuer definition should be revised to conform to existing Forms S-3 and F-3 because requiring an additional 24 months of reporting history does not enhance the ability of these issuers to fend for themselves.

ABA appreciated FINRA's attempt to streamline Rule 5110 by using the defined term experienced issuer but suggested that the criteria is outdated and the exemption should be available to any issuer who is eligible to file a registration statement under the SEC's current requirements for Forms S-3, F-3 and F-10. If limiting the exemption beyond the current requirements for Forms S-3, F-3 and F-10 is necessary for the protection of investors, ABA requested that FINRA consider revising the definition to also cover issuers with a 12 month reporting history if they have: (1) a public float of at least $75 million; and (2) average daily trading volume (as defined in SEC Regulation M) in their common equity securities of at least $1 million and also requested exempting issuers that meet these criteria that are filing on SEC Form N-2.

Rather than referring to the pre-1992 standards for Form S-3 and F-3 and standards approved in 1991 for Form F-10, the proposed definition of experienced issuer codifies those standards currently in Rule 5110 to simplify the analysis for the benefit of members. The continued application of the Rule to these issuers continues to be justified.[139] The proposed rule change intentionally uses language different from that used in other requirements (e.g., Form S-3's use of "seasoned issuer") to avoid confusion and make clear that the defined term covers a different set of issuers.

Two commenters stated that retaining the current definition of "institutional investor" is problematic and difficult to use, thereby rendering the venture capital exceptions in proposed Rule 5110(d)(2) and (3) largely unworkable.[140] SIFMA stated that, given the expansive definition of "participating member," it is difficult to ascertain whether an entity qualifies as an institutional investor and that the focus of the definition should instead be on whether a participating member manages the investor's investments or otherwise controls or directs the investment decisions of the investor.

SIFMA suggested defining the term "institutional investor" to mean a "person that has an aggregate of at least U.S. $50 million invested in securities in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members manage the institutional investor's investments or otherwise control or direct the investment decisions of such investor." Alternatively, if

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139 See supra discussion of previous problems associated with shelf offerings in Item 3.

140 See Davis Polk and SIFMA.

the equity interest element of the definition is not deleted, SIFMA proposed that the: (1) reference to "equity interest" be changed to "beneficial ownership" as defined in Rule 5121; (2) thresholds for both public and non-public entities be raised to 15 percent and the reference to "entity" be changed to "investor" (due to the incorporation by reference of the specific definition of "entity" in Rule 5121 which does not fit well in this specific context in Rule 5110); and (3) calculation of the beneficial ownership threshold be limited to ownership by the participating FINRA member and its affiliates (i.e., the calculation should not include associated persons that are not otherwise "affiliates" of the member or immediate family of such persons).

Revising the institutional investor definition as suggested to focus on controlling or directing investment decisions would insert uncertainty and subjectivity into the definition. The proposed rule change retains this definition because the current definition is more objective. Moreover, because Rule 5110's venture capital exceptions are relied upon by members, FINRA does not agree that the institutional investor definition makes the venture capital exceptions unworkable.

Two commenters suggested that the Notice 17-15 Proposal's addition of "other than the issuer" at the end of the definition of "participating member" does not make it clear that the issuer is exempted from all categories of participating member.[141] To make clear that the definition does not include the issuer, the proposed rule change would define participating member to mean "any FINRA member that is participating in a

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[141] See ABA and Rothwell.

public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer."[142]

Three commenters stated that the proposed carve-out of the "issuer" from the definition of "participating member" is useful and would help with inadvertent overlap between the two definitions.[143] These commenters suggested that a comparable carve-out to include participating members be included in the definition of "issuer." The proposed rule change does not incorporate the suggested change to the definition of "issuer" because a participating member could also be the issuer of the securities.

SIFMA stated that the proposed definition of "issuer" referencing an "entity" offering its securities to the public may be confusing given that the defined term "entity" in Rule 5121 excludes certain types of issuers such as DPPs and REITs. To address this issue, SIFMA suggested that "issuer" be defined to mean the "registrant or other person offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant, such other person or selling security holder (other than an affiliate that is a participating member), and the officers or general partners, and directors thereof." To clarify the scope of covered persons, the proposed rule change would revise the issuer definition to refer to the "registrant or other person" (rather than "entity").[144]

ABA stated that while proposed Rule 5110(j)(2) would define the term "bank" for purposes of the Rule's venture capital exceptions, the term "bank" is not defined for

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[142] See proposed Rule 5110(j)(15).

[143] See ABA, Rothwell and SIFMA.

[144] See proposed Rule 5110(j)(12).

purposes of the exemption for qualifying bank securities under proposed Rule 5110(h)(1). As the purpose of the proposed Rule 5110(h)(1) exemption is to exempt offerings by qualifying issuers, ABA stated that the exemption should include non-U.S. bank issuers and should not be limited to banks as defined in Exchange Act Section 3(a)(6), which definition is largely limited to U.S. domiciled banks and U.S.-based branches of non-U.S. banks.

The proposed rule change would harmonize the definition of bank in the proposed venture capital exceptions and the Rule 5110(h)(1) exemption. Specifically, the proposed rule change would define bank for purposes of Rule 5110 as "a bank as defined in Exchange Act Section 3(a)(6) or is a foreign bank that has been granted an exemption under this Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates."[145] This harmonized approach combines the definition of bank currently in Rule 5110, with the scope of banking entities currently covered by the venture capital exceptions.

ABA supported clarifying and codifying the relevant "review period" through a defined term but requested additional guidance regarding when the review period would end for offerings with an indeterminate time period such as at-the-market offerings. An at-the-market offering would be a takedown offering and the corresponding review period is set forth in proposed Rule 5110(j)(20)(C). Additional guidance regarding other offerings with indeterminate time periods may be provided as necessary or appropriate.

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145 See proposed Rule 5110(j)(2). Because of this expanded definition, the proposed rule change would delete as unnecessarily duplicative the conditions in the venture capital exceptions.

ABA questioned why the review period in proposed Rule 5110(j)(20)(C) would be limited to firm commitment or best efforts takedowns or any other continuous offering "on behalf of security holders" and requested that the definition be revised to include the issuer. ABA suggested that as proposed "on behalf of security holders" appears to qualify "firm commitment," "best efforts" and "other continuous offering" for the purpose of the review period definition. The reference to "on behalf of securities holders" was not intended to limit proposed Rule 5110(j)(20)(C) as suggested. To clarify the intended scope of the definition, the proposed rule change deletes the reference to "on behalf of security holders."

Davis Polk stated that because the review period is defined to include the 60-day period following the effective date of a firm commitment offering (or following the final closing for other offerings), participating members would be required to provide FINRA with information regarding any fees or other compensation received by them, their affiliates, associated persons, and immediate family of associated persons for 60 days following the offering, which represents a significant diligence burden. Providing a specific time period gives clarity to participating members. Moreover, the inclusion of a short period of time following the offering prevents circumvention of the Rule 5110 and is consistent with current rule, which has a 90-day requirement.

Davis Polk suggested that the definition of "required filing date" be modified for offerings that are dormant for a period of six months or more. Because the exceptions from underwriting compensation are unavailable for securities acquired by participating members after the first confidential submission to or public filing of the registration statement with the SEC, an issuer may not be able to accept financing from a participating member because of potentially excessive underwriting compensation. Accordingly, Davis Polk suggested either the definition of "required filing date" should be modified or the exceptions from underwriting compensation should be modified to apply to acquisitions by participating members of the issuer's securities after the required filing date. If the former, Davis Polk suggested that the definition provide that with respect to offerings that are dormant for six months or more, the review period begin upon the filing of the first amendment to the registration statement, which has been confidentially or publicly filed with the SEC, following the dormant period.

Availability of a venture capital exception is contingent upon the securities being acquired before the required filing date because after that date, in FINRA's experience, securities acquisitions are more likely to be underwriting compensation and issuers may be more dependent on a particular underwriter or underwriters to raise necessary capital. A public offering may be significantly delayed for legitimate reasons (e.g., unfavorable market conditions) and during this delay the issuer may require funding to operate its business or continue as a going concern. Furthermore, a member may make bona fide investments in or loans to the issuer during this delay to satisfy the issuer's funding needs and any securities acquired as a result of this funding may be unrelated to the anticipated public offering. The proposed rule change would provide some additional flexibility in the availability of the venture capital exceptions for securities acquired where the public offering has been significantly delayed as discussed above in a principles-based approach in proposed Supplementary Material .02 to Rule 5110.

<u>Valuation of Securities</u>

The <u>Notice</u> 17-15 Proposal removed the valuation formula for convertible securities and instead allowed for convertible securities to be valued 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. NASAA stated that the NASAA Underwriting Expenses Statement of Policy uses the same formula as current Rule 5110 for the valuation of underwriter's warrants in calculating total underwriting expenses. NASAA stated that the current valuation formula serves a useful purpose by providing an objective valuation method that provides consistency across different offerings and suggested that FINRA consider retaining the existing formula as a continued optional method of valuation. NASAA also urged FINRA to reexamine whether it is appropriate for an issuer to grant any options or warrants to underwriters as potential conflicts could impact the due diligence process.

EGS stated that Rule 5110 should continue to have a single valuation method to process filings in a consistent, predictable and efficient manner. EGS's expressed concerns with the approach in <u>Notice</u> 17-15 Proposal included: (1) varying methods will yield inconsistent results from dealer to dealer and deal to deal; and (2) assessment of a new valuation method during the pendency of a filing would delay resolution of that filing and divert FINRA staff's time and attention away from other filings.

Rothwell supported removal of the current Rule 5110 formula for valuing options but questioned whether, as a matter of policy, FINRA would continue to accept the warrant formula as a valuation method for securities that have an exercise or conversion price. Rothwell stated that there are situations where the warrant formula may continue to be a viable method for valuing securities.

SIFMA supported removal of the current Rule 5110 formula for valuing options, warrants and convertible securities to instead allow members to use a commercially available valuation method but requested additional guidance as to what should be filed with respect to such methodology. SIFMA stated that in addition to commercially available valuation models, the use of proprietary valuation models should be permitted if the member uses such a model in the ordinary course of its business to value securities of a similar type and files a description of the methodology with FINRA.

The Notice 17-15 Proposal requested comment on whether the proposed change to the valuation method was appropriate and whether the valuation method should be limited to one that is commercially available. Some commenters supported the proposed change, while others did not. Commenters did not provide any information regarding use of commercially available valuation methods, such as what methods are available and their anticipated benefits. The proposed rule change would retain the current Rule 5110 formula for valuing options, warrants and convertible securities because of the conflicting views on the proposed change to the valuation formula and the lack of information regarding what commercially available valuation methods may be used by members.

Two commenters stated that, consistent with the current Rule, members should be allowed to value non-convertible securities that are currently trading in the secondary market based on the difference between the market price at the time of acquisition (rather than the public offering price) and the acquisition cost.[146] The proposed rule change

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146 See Rothwell and SIFMA.

would retain the current Rule 5110 formula and, consequently, would allow members to value non-convertible securities that are currently trading in the secondary market based on the difference between the market price at the time of acquisition (rather than the public offering price) and the acquisition cost.

Rothwell stated that the valuation of unit securities is not addressed in either the current Rule 5110 or the proposed rule change. Rothwell speculated that FINRA looks through the unit to value the individual components and ascribe an additional value to the warrant within the unit even though the purchaser may have paid the same price for the unit as the public offering price. Rothwell stated that the unit security should instead be valued as a non-convertible security (as the unit is a security that does not itself have an exercise or conversion price) and that the unit securities should have a zero value and should not be ascribed an additional value when a participating member acquires a non-convertible unit at the same price as the public offering price of the unit. FINRA has previously provided guidance, with accompanying examples, for valuing unit securities.[147] This guidance remains valid and illustrative. FINRA does not agree with the commenter's proposed approach to valuing unit securities because a unit given to an underwriter may include a warrant with unique terms, which should be considered in evaluating underwriting compensation.

Numerical Stock Limit

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 10 percent of the number or dollar

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147 See Notice to Members 92-28 (May 1992).

amount of securities being offered to the public. FINRA eliminated this requirement as unnecessary as the convertible securities valuation formula in current Rule 5110 results in a de facto stock numerical limit.[148] Given the proposed elimination of the convertible securities valuation formula in the Notice 17-15 Proposal, that Proposal requested comment on whether a new stock numerical limit should be included in Rule 5110.

NASAA suggested reinstating the numerical stock limit if FINRA determines to eliminate the convertible securities valuation formula. Rothwell stated that FINRA should not now impose a limit in a manner that would artificially restrict permissible venture, lending and other services that benefit corporate financing clients. Rothwell also stated that any numerical restriction on private placement purchases by a member or affiliate of the securities of the issuer would be contrary to the interest of issuers that look to the FINRA members that will participate in its public offering to also purchase a significant portion of any pre-IPO private placement. Similarly, Rothwell stated that the customers of such members that purchase pre-IPO private placement securities generally expect that the member will share the risk of the investment by being a co-investor. With respect to securities acquired in venture and lending activities where the participating member must take a significant financial investment, Rothwell stated that the current requirements of Rule 5110 have and will continue to effectively limit the amount of securities acquired as underwriting compensation.

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[148] See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

Because the proposed rule change would retain the current Rule 5110 formula for valuing options, warrants and convertible securities, the proposed rule change does not incorporate a new stock numerical limit.

Exemptive Relief

As set forth in the Notice 17-15 Proposal, Rule 5110 would have been amended to provide that FINRA may in exceptional and unusual circumstances exempt a member from any or all or the provisions in the Rule that FINRA deems appropriate in lieu of the current approach that appropriate FINRA staff, for good cause shown may grant a conditional or unconditional exemption from any of the Rule's provisions. Two commenters questioned whether the change from the exemptive relief provision in the current Rule is intended to limit the circumstances in which an exemption may be sought.[149]

The Notice 17-15 Proposal would have amended the exemptive relief provision in Rule 5110 to be consistent with the exemptive relief provision in the more recently amended Rule 5121. Because the change was not intended to alter the circumstances in which exemptive relief may be sought, the proposed rule change would revert to the language in current Rule 5110 to avoid any confusion regarding the granting of exemptive relief.

Non-Cash Compensation

While acknowledging that the non-cash compensation-related provisions in the Notice 17-15 Proposal are also in the current Rule, SIFMA recommended clarifying these provisions and eliminating inherent inconsistencies between the provisions and the rest of

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[149] See ABA and SIFMA.

the Rule. To this end, SIFMA suggested revising proposed Rule 5110(f)(2) to state "in connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision, 'or as permitted elsewhere in this Rule.'" Alternatively, SIFMA suggested adding guidance in the Supplementary Material providing that the receipt of non-cash compensation items (including securities, derivatives and ROFRs) that are permitted under other provisions of Rule 5110 will not be prohibited by, or deemed inconsistent with, the restrictions in Rule 5110(g).

ABA also suggested addressing Rule 5110's non-cash compensation-related provisions in this proposed rule change. ABA suggested that if applied literally, the non-cash compensation provisions state that members may not receive any non-cash compensation other than those limited items set forth in the provision itself, and those items do not include certain forms of non-cash compensation such as securities, derivative instruments or ROFRs that are expressly permitted elsewhere in the Rule.

Consistent with the Notice 17-15 Proposal, because the provisions are the subject of a separate consolidated approach to non-cash compensation, the proposed rule change would incorporate the Rule's current non-cash compensation provisions without modification.

Rule 5121

ABA suggested some clarifications and amendments to Rule 5121. Because any substantive changes to Rule 5121 are more appropriately considered as part of FINRA's separate consideration of our rules and programs governing the capital raising process and their effects on capital formation, this proposed rule change does not include any amendments to Rule 5121 beyond the conforming definitional amendments discussed above.

Regulation A+

ADISA stated that FINRA should be more responsive to the review and clearance of filings made pursuant to SEC Regulation A+ as extensive and long reviews of those offerings have impacted members' ability to effectively raise capital through the public markets. FINRA will continue to review our internal operations and administrative processes to improve the review and clearing of these filings. Separate from this proposed rule change, FINRA will consider the appropriateness of issuing guidance regarding underwriting and related services and financial services provided to issuers in offerings pursuant to Regulation A+.

Guidance

EGS requested that the Public Offering Frequently Asked Questions available on FINRA's website be enhanced and that FINRA publish informal interpretations more broadly and circulate guidance to members and their counsel more frequently. If the proposed rule change is approved, FINRA will consider providing additional guidance as necessary and appropriate.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[150]

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[150] 15 U.S.C. 78s(b)(2).

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 17-15 (April 2017).

Exhibit 2b. List of commenters.

Exhibit 2c. Comments received in response to Regulatory Notice 17-15.

Exhibit 4. Text of proposed rule change as if adopted.

Exhibit 5. Text of proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2019-012)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) to Make Substantive, Organizational and Terminology Changes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on , Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) (the "Rule") to make substantive, organizational and terminology changes to the Rule. The proposed rule change is intended to modernize Rule 5110 and to simplify and clarify its provisions while maintaining important protections for market participants, including issuers and investors participating in offerings. The proposed rule change would also update cross-references and make other

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

2 17 CFR 240.19b-4.

non-substantive changes within FINRA rules due to the proposed amendments to Rule 5110.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Since its adoption in 1992 in response to persistent problems with underwriters dealing unfairly with issuers, Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in connection with the public offering of securities. Moreover, Rule 5110 continues to be important to ensuring investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

Rule 5110 requires a member that participates in a public offering to file documents and information with FINRA about the underwriting terms and arrangements.[3] FINRA's Corporate Financing Department ("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.[4]

Rule 5110 was last revised in 2004 to better reflect the various financial activities of multi-service members.[5] 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

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3 The following are examples of public offerings that are routinely filed: (1) initial public offerings ("IPOs"); (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs ("DPPs") as defined in FINRA Rule 2310(a)(4) (Direct Participation Programs); (6) offerings by real estate investment trusts ("REITs"); (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.

4 FINRA does not approve or disapprove 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 member may proceed with a public offering only if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements. See current Rule 5110(b)(4)(B)(ii). See also proposed Rule 5110(a)(1)(C)(ii).

5 In recognition of the expansion in the variety of services provided by members to their corporate financing clients, such as venture capital investment, financial consulting, commercial lending, hedging risk through derivative transactions and investment banking services, the Rule was revised in 2004 to accommodate the expanded corporate financing activities of members, while protecting issuers and investors from unreasonable or coercive practices. See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

retrospective review[6] to further modernize the Rule by, among other things, significantly improving the administration of the Rule and simplifying the Rule's provisions while maintaining important protections for market participants, including issuers and investors participating in offerings.

As part of this retrospective review, FINRA engaged in extensive consultation with the industry to better understand what aspects of the Rule needed to be modernized, simplified and clarified. This retrospective review, including its industry consultation component and comments FINRA received in response to Regulatory Notice 17-15 (April 2017) ("Notice 17-15 Proposal") (as further discussed in Items II.B. and II.C. infra), has shaped and informed this proposed rule change. The proposed rule change includes a range of amendments to Rule 5110, including reorganizing and improving the readability of the Rule. FINRA proposes changes to the following areas: (1) filing requirements; (2) filing requirements for shelf offerings; (3) exemptions from filing and substantive requirements; (4) underwriting compensation; (5) venture capital exceptions; (6) treatment of non-convertible or non-exchangeable debt securities and derivatives; (7) lock-up restrictions; (8) prohibited terms and arrangements; and (9) defined terms.[7] The

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6 Because the review began before FINRA initiated formal retrospective review procedures, it did not follow the specific procedures that are now followed.

7 As discussed below, the proposal retains the current approach to itemized disclosure of underwriting compensation, but makes explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation, such as exercise terms, in the prospectus. In addition, the proposed rule change 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).

changes to these areas should lessen the regulatory costs and burdens incurred when complying with the Rule.

Filing Requirements

The proposed rule change would amend Rule 5110's filing requirements to create a process that is both more flexible and more efficient for members. The proposed rule change would allow members more time to make the required filings with FINRA (from one business day after filing with the SEC or a state securities commission or similar state regulatory authority to three business days).[8] This change is intended to help with logistical issues or inadvertent delays in making filings without impeding FINRA's ability to timely review the underwriting terms and arrangements.

The proposed rule change would clarify and further reduce the types of documents and information that must be filed by directing members to provide the SEC document identification number if available,[9] and require filing: (1) industry-standard master forms of agreement only if specifically requested to do so by FINRA;[10] (2) amendments to previously filed documents only if there have been changes relating to the disclosures that impact the underwriting terms and arrangements for the public offering in

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8 See proposed Rule 5110(a)(3)(A). The documents and information required to be filed under Rule 5110 are filed in FINRA's Public Offering System ("FINRA System") for review and, if available, the associated SEC document identification number should be provided. See proposed Rule 5110(a)(4).

9 Depending on the filing type, an SEC document identification number could include a document control number, document file number or accession number. For purposes of clarity, the lack of an SEC document identification number does not obviate the need to submit the documents and information set forth in proposed Rule 5110(a)(4).

10 See proposed Rule 5110(a)(4)(A)(ii). A member may use a master form of agreement which is a standard form used across like offerings and transactions in which the member participates (e.g., a master agreement among underwriters).

those documents;[11] (3) a representation as to whether any associated person or affiliate of a participating member is a beneficial owner of 5 percent or more of "equity and equity-linked securities";[12] and (4) an estimate of the maximum value for each item of underwriting compensation.[13]

The proposed rule change would clarify that a member participating in an offering is not required to file with FINRA if the filing has been made by another member participating in the offering.[14] In addition, rather than providing a non-exhaustive list of types of public offerings that are required to be filed, the proposed rule change would instead state that a public offering in which a member participates must be filed for review unless exempted by the Rule.[15] The proposed rule change would clarify the general standard that no member may engage in the distribution or sale of securities unless FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.[16] The proposed rule change also would clarify that any member acting as a managing underwriter or in a similar capacity must notify the

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[11] See proposed Rule 5110(a)(4)(A)(iii).

[12] See proposed Rule 5110(a)(4)(B)(iii) and proposed Rule 5110(j)(7). Contrast with current Rule 5110(b)(6)(A)(iii), which requires a statement or association related to "any class of the issuer's securities."

[13] See proposed Rule 5110(a)(4)(B)(ii).

[14] See proposed Rule 5110(a)(3)(B). 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. As discussed infra, issuer filings continue to be permitted for shelf offerings.

[15] See proposed Rule 5110(a)(2). As discussed infra, the proposed rule change would add the defined term "public offering" to Rule 5110.

[16] See proposed Rule 5110(a)(1)(C).

other members participating in the public offering if informed of an opinion by FINRA that the underwriting terms and arrangements are unfair and unreasonable and the proposed terms and arrangements have not been appropriately modified.[17] Providing members with more time to file relevant documents and information and reducing the filing of duplicative or otherwise unnecessary documents and information would lessen members' filing burdens while maintaining the Rule's important protections for market participants.

The new provision addressing terminated offerings provides that, when an offering is not completed according to the terms of an agreement entered into by the issuer and a member, but the member has received underwriting compensation, the member must give written notification to FINRA of all underwriting compensation received or to be received, including a copy of any agreement governing the arrangement.[18] Information regarding underwriting compensation received or to be received in terminated offerings is relevant to FINRA's evaluation of compliance with Rule 5110 and, in particular, paragraph (g)(5) of the proposed Rule. This new provision would allow FINRA to provide more effective oversight when a member's services have been terminated.

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17 See proposed Rule 5110(a)(1)(B).

18 See proposed Rule 5110(a)(4)(C) and proposed Rule 5110(g)(5). In 2014, FINRA amended Rule 5110 to expand and specify the circumstances under which underwriting compensation in excess of a reimbursement of out-of-pocket expenses, such as termination fees and rights of first refusal ("ROFR"), could be received in connection with an offering that was not completed or when a member was terminated from an offering. See Securities Exchange Act Release No. 72114 (May 7, 2014), 79 FR 27355 (May 13, 2014) (Order Approving File No. SR-FINRA-2014-004).

Filing Requirements for Shelf Offerings

Issuers meeting specified reporting history and other requirements are eligible to use shelf registration statements. A shelf-eligible issuer can use a shelf takedown to publicly offer securities on a continuous or delayed basis to meet funding needs or to take advantage of favorable market windows. Public offerings by some shelf-eligible issuers have historically been exempt from Rule 5110's filing requirement; however, for the reasons discussed below, public offerings by other shelf-eligible issuers have historically been subject to Rule 5110's filing requirement. The proposed rule change would codify the historical standards for public offerings that are exempt from the filing requirement and would streamline the filing requirements for shelf offerings that remain subject to the filing requirement.

Public Offerings Exempt from the Filing Requirement

Substantively consistent with the current Rule, the proposed rule change would exempt from Rule 5110's filing requirement a public offering by an "experienced issuer" (i.e., an issuer with a 36-month reporting history and at least $150 million aggregate market value of voting stock held by non-affiliates or, alternatively, the aggregate market value of voting stock held by non-affiliates is at least $100 million and the issuer has an annual trading volume of three million shares or more in the stock).[19] Unless subject to another exemption, public offerings of issuers that do not meet the reporting history or

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[19] The proposed rule change 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 or alternatively the aggregate market value of voting stock held by non-affiliates is at least $100 million and the issuer has an annual trading volume of three million shares or more in the stock. See proposed Rule 5110(j)(6).

float requirement to be codified in the experienced issuer definition have historically been subject to Rule 5110's filing requirement, including shelf offerings by these issuers.

Public Offerings Subject to the Filing Requirement

There are many benefits for eligible issuers in using a shelf registration statement, including the ability of issuers to take advantage of favorable market conditions on short notice to quickly raise capital through takedown offerings. While shelf offerings have historically been less likely to have compliance problems, previously filed shelf offerings have given rise to issues under Rule 5110, including those related to: (1) excessive underwriting compensation; (2) indeterminate underwriting compensation in the form of convertible debt or equity securities that do not have a market value; (3) undisclosed underwriting compensation, primarily in the form of uncapped expense reimbursements; and (4) termination fees and ROFRs that do not satisfy the Rule's requirements.

Given the issues that have arisen in shelf offerings, the proposed rule change would continue to apply Rule 5110's filing requirement to shelf offerings by issuers that do not meet the "experienced issuer" standard. However, to facilitate the ability of issuers to take advantage of favorable market conditions on short notice to quickly raise capital through takedown offerings, the proposed rule change would streamline the filing requirements for shelf offerings. The proposed rule change would provide that only the following documents and information must be filed: (1) the Securities Act of 1933 ("Securities Act") registration statement number; and (2) if specifically requested by FINRA, other documents and information set forth in Rule 5110(a)(4)(A) and (B).[20]

20 See proposed Rule 5110(a)(4)(E).

FINRA would access the base shelf registration statement, amendments and prospectus supplements in the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system and populate the information necessary to conduct a review in the FINRA System. Upon filing of the required registration statement number and documents and information, if any, that FINRA requested pursuant to proposed Rule 5110(a)(4)(E), FINRA would provide the no objections opinion. To further facilitate issuers' ability to timely access capital markets, FINRA's review of documents and information related to a shelf takedown offering for compliance with Rule 5110 would occur on a post-takedown basis.[21]

Exemptions from Filing and Substantive Requirements

Rule 5110 includes two categories of exempt public offerings – offerings that are exempt from filing, but remain subject to the substantive provisions of Rule 5110, and offerings that are exempt from both the filing requirements and substantive provisions of Rule 5110. The proposed rule change would expand and clarify the scope of the exemptions, which is expected to reduce members' filing and compliance costs.

Consistent with historical practice in interpreting the exemption that is currently available to corporate issuers, the proposed rule change would clarify that securities of banks that have qualifying outstanding debt securities are exempt from the filing requirement.[22]

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21 Issuers would continue to be permitted to file a base shelf registration statement in anticipation of retaining a member to participate in a takedown offering.

22 See proposed Rule 5110(h)(1)(A). The exemption has historically been interpreted to apply to qualifying securities offered by a bank; however, the lack of a specific reference to bank securities in the Rule text has raised questions by members.

The proposed rule change would also expand the current list of offerings that are exempt from both the filing requirements and substantive provisions of Rule 5110 to include public offerings of closed-end "tender offer" funds (i.e., closed-end funds that repurchase shares from shareholders pursuant to tender offers), insurance contracts and unit investment trusts.[23] Exempting these public offerings is appropriate because they relate to highly regulated entities governed by the Investment Company Act of 1940 ("Investment Company Act") whose offering terms would be subject to FINRA Rule 2341 (Investment Company Securities). In addition, as discussed infra, in response to comments to the Notice 17-15 Proposal, the proposed rule change reclassifies three items from the offerings exempt from filing and rule compliance to offerings excluded from the definition of public offering. The three items are: (1) offerings exempt from registration with the SEC pursuant to Section 4(a)(1), (2) and (6) of the Securities Act; (2) offerings exempt from registration under specified SEC Regulation D provisions; and (3) offerings of exempted securities as defined in Section 3(a)(12) of the Exchange Act. This reclassification is consistent with the treatment of such offerings in FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest).[24]

Disclosure Requirements

The SEC's Regulation S-K requires fees and expenses identified by FINRA as underwriting compensation to be disclosed in the prospectus.[25] The Notice 17-15 Proposal would have modified Rule 5110's underwriting compensation disclosure

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[23] See proposed Rule 5110(h)(2)(E), (K) and (L).

[24] See proposed Rule 5110(j)(18).

[25] See 17 CFR 229.508(e).

requirements. Although a description of each item of underwriting compensation would have been required to be disclosed, the Notice 17-15 Proposal would have no longer required that the disclosure include the dollar amount ascribed to each individual item of compensation. Rather, the Notice 17-15 Proposal would have permitted a member 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.

FINRA is no longer proposing to eliminate the itemized disclosure that Rule 5110 currently requires. As discussed in Item II.C. infra, commenters had conflicting views on the proposed change to allow aggregation of underwriting compensation with one commenter stating that the itemized disclosure may be beneficial for investors in better understanding the underwriting compensation paid and incentives that may be present in the public offering. Recognizing commenters' conflicting views, the proposed rule change would retain the current requirements for itemized disclosure of underwriting compensation and disclosing dollar amounts ascribed to each such item.[26] The proposed rule change would incorporate the requirements for disclosure of specified material terms and arrangements that are consistent with current practice.[27]

The Notice 17-15 Proposal also included an explicit requirement to disclose specified material terms and arrangements in the prospectus. The current proposal includes the same obligation, which makes explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation in the prospectus. This explicit provision would require a description for: (1) any ROFR

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26 See proposed Rule 5110(b)(1) and Supplementary Material .05 to Rule 5110. See also proposed Rule 5110(e)(1)(B) requiring disclosure of lock-ups.

27 See proposed Supplementary Material .05 to Rule 5110.

granted to a participating member and its duration; and (2) the material terms and arrangements of the securities acquired by the participating member (e.g., exercise terms, demand rights, piggyback registration rights and lock-up periods).[28]

Underwriting Compensation

The proposed rule change would clarify what is considered underwriting compensation for purposes of Rule 5110. As an initial matter, the proposed rule change would consolidate the various provisions of the current Rule that address what constitutes underwriting compensation into a single, new definition of "underwriting compensation." Underwriting compensation would be defined 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's fees, underwriter's counsel fees and securities."[29]

Rule 5110 currently provides that all items of value received or to be received from any source are presumed to be underwriting compensation when received during the period commencing 180 days before the required filing date of the registration statement, and up to 90 days following the effectiveness or commencement of sales of a public offering.[30] However, this approach may not reflect the various types of offerings subject to Rule 5110. For example, a best efforts offering may be distributed for months or years

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28 See proposed Supplementary Material .05 to Rule 5110.

29 See proposed Rule 5110(j)(22).

30 See current Rule 5110(d)(1). See also current Rule 5110(b)(6)(A)(vi)b. which provides that details of any new arrangement entered into within 90 days following the date of effectiveness or commencement of sales of the public offering must be filed.

and underwriters may receive compensation throughout the offering period, or a base shelf registration statement may become effective months or years before a takedown offering for which an underwriter is compensated.

To better reflect the different types of offerings subject to Rule 5110, the proposed rule change would introduce the defined term "review period" and the applicable time period would vary based on the type of offering. Specifically, the proposed rule change would define the review period to mean: (1) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering; (2) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and (3) for a firm commitment or best efforts takedown or any other continuous offering made pursuant to Securities Act Rule 415, the 180-day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.[31] Accordingly, payments and benefits received during the applicable review period would be considered in evaluating underwriting compensation.

The proposed rule change would continue to provide two non-exhaustive lists of examples of payments or benefits that would be and would not be considered underwriting compensation.[32] Although the Rule would no longer incorporate the concept of "items of value" (i.e., the non-exhaustive list of payments and benefits that would be included in the underwriting compensation calculation), the proposed non-

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31 See proposed Rule 5110(j)(20).

32 See proposed Supplementary Material .01 to Rule 5110.

exhaustive lists are derived from the examples of payments or benefits that currently are considered and not considered items of value. The proposed examples of payments or benefits that would be underwriting compensation is comparable to the list of items of value in the current Rule with some additional clarifying changes. For example, the proposed rule change would expand the current item of value related to reimbursement of expenses to provide that fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses, would be underwriting compensation.[33] Consistent with current practice, the proposed rule change would also include in underwriting compensation non-cash compensation.[34]

The proposed examples of payments or benefits that would not be underwriting compensation include several new examples to provide greater clarity and to address questions raised by members. For instance, in response to questions from members, the proposed rule change would clarify that payments for records management and advisory services received by members in connection with some corporate reorganizations would not be considered underwriting compensation.[35] Similarly, the proposed rule change would clarify that the payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer would not be considered

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33 See proposed Supplementary Material .01(a)(2) to Rule 5110. See also proposed Supplementary Material .01(a)(3) and (4) to Rule 5110 which includes fees and expenses of participating members' counsel and finder's fees paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement of "blue sky" fees) as underwriting compensation.

34 See proposed Supplementary Material .01(a)(14) to Rule 5110.

35 See proposed Supplementary Material .01(b)(3) to Rule 5110.

underwriting compensation.[36] The proposed rule change also would clarify that securities acquired pursuant to a governmental or court approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding) would not be considered underwriting compensation.[37] These payments are for services beyond the traditional scope of underwriting activities and, therefore, are appropriately excluded from the coverage of Rule 5110.

In addition, to give members reasonable flexibility with respect to issuer securities acquired in certain circumstances, the proposed rule change would take a principles-based approach in considering whether issuer securities acquired from third parties or in directed sales programs may be excluded from underwriting compensation. This principles-based approach starts with the presumption that the issuer securities received during the review period would be underwriting compensation. However, FINRA would consider the factors set forth in proposed Supplementary Material to Rule 5110 and discussed below in determining whether the securities may be excluded from underwriting compensation.[38] A participating member is responsible for providing documents and information sufficient for FINRA to consider in applying the factors to a particular securities acquisition.

With respect to issuer securities received from third parties, it is important to note that the proposed definition of "underwriting compensation" would include payments, rights, interests, or benefits received or to be received by a participating member from

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[36] See proposed Supplementary Material .01(b)(4) to Rule 5110.

[37] See proposed Supplementary Material .01(b)(22) to Rule 5110. See also comments from ABA, Davis Polk and SIFMA discussed in Item II.C. infra.

[38] See proposed Supplementary Material .03 and .04 to Rule 5110.

any source for underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering. However, some acquisitions of issuer securities from third parties for purposes unconnected to underwriting compensation should not be deemed underwriting compensation (e.g., securities acquired in ordinary course transactions executed over a participating member's trading desk during the review period from third parties).

To address these situations, the proposed rule change uses a principles-based approach to considering whether securities of the issuer acquired from third parties may be excluded from underwriting compensation. Specifically, under proposed Supplementary Material .03 to Rule 5110, FINRA would consider the following factors, as well as any other relevant factors and circumstances: (1) the nature of the relationship between the issuer and the third party, if any; (2) the nature of the transactions in which the securities were acquired, including, but not limited to, whether the transactions are engaged in as part of the participating member's ordinary course of business; and (3) any disparity between the price paid and the offering price or market price.

With respect to issuer securities acquired in directed sales programs (commonly called friends and family programs), it is important to note that the proposed definition of "participating member" includes any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family of an associated person of the member, but does not include the issuer.[39] However, associated persons and their immediate family members may have relationships with issuers that motivate the issuer to sell these persons shares in directed sales programs.

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[39] See proposed Rule 5110(j)(15).

These acquisitions may be unrelated to the investment banking services provided by the participating member.

To address these situations, under the proposed rule change FINRA would take a principles-based approach to considering whether an acquisition of securities by a participating member pursuant to an issuer's directed sales program may be excluded from underwriting compensation. Specifically, under proposed Supplementary Material .04 to Rule 5110, FINRA would consider the following factors, as well as any other relevant factors and circumstances: (1) the existence of a pre-existing relationship between the issuer and the person acquiring the securities; (2) the nature of the relationship; and (3) whether the securities were acquired on the same terms and at the same price as other similarly-situated persons participating in the directed sales program.

Venture Capital Exceptions

Rule 5110 currently provides exceptions designed to distinguish securities acquired in bona fide venture capital transactions from those acquired as underwriting compensation (for brevity, referred to herein as the "venture capital exceptions").[40] Recognizing that bona fide venture capital transactions contribute to capital formation, the proposed rule change would modify, clarify and expand the exceptions to further facilitate members' participation in bona fide venture capital transactions. Importantly, the venture capital exceptions would include several restrictions to ensure the protection of other market participants and that the exceptions are not misused to circumvent the requirements of Rule 5110.

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40 See current Rule 5110(d)(5).

The proposed rule change would no longer treat as underwriting compensation securities acquisitions covered by two of the current exceptions: (1) securities acquisitions and conversions to prevent dilution; and (2) securities 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. Accordingly, the proposed rule change would add these acquisitions to the list of examples 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.[41]

The proposed rule change also would broaden two of the current venture capital 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.[42] 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 members at a time when there was a concern about limiting the aggregate amount of equity acquired in pre-offering transactions. Subsequent regulatory changes in other areas, such as the 2009 revision of

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41 See proposed Supplementary Material .01(b)(14), (16-18).

42 See proposed Rule 5110(d)(1) and (2).

Rule 5121 regarding public offerings with a conflict of interest,[43] have added protections and are more appropriate to address acquisitions that create control relationships.

These venture capital exceptions specify that the affiliate must be primarily in the business of making investments or loans. The proposed rule change expands the scope of these exceptions to include that the affiliate, directly or through a subsidiary it controls, must be in such business and further permits that the entity may be newly formed by such affiliate. Expanding the scope of the exceptions to cover direct, indirect or newly formed entities that are in the business of making investments and loans acknowledges the different structures that may be used to participate in bona fide venture capital transactions.[44]

Another venture capital exception relates to private placements with institutional investors. The exception would be available only when the institutional investors participating in the offering are not affiliates of a FINRA member. This ensures that such institutional investors are independent sources of capital. The provision is further clarified to require that the institutional investors must purchase at least 51 percent of the total number of securities sold in the private placement at the same time and on the same terms. In addition, the proposed rule change would raise the percent that participating members in the aggregate may acquire from 20 to 40 percent of the securities sold in the private placement.[45] These private placements typically occur before the syndicate is

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43 Rule 5121 requires prominent disclosure of conflicts and, for certain types of conflicts, the participation of a qualified independent underwriter ("QIU") in the preparation of the registration statement.

44 See proposed Rule 5110(d)(1)(D) and (d)(2)(A)(iv).

45 See proposed Rule 5110(d)(3)(C).

formed and, therefore, members may 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 members to the compensation limits, disclosure provisions and lock-up provisions of the Rule, the current 20 percent threshold reduces the number of members available for the syndicate. Increasing the threshold would allow more members 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.

In response to comments to the Notice 17-15 Proposal, the proposed rule change would expand the scope of proposed Rule 5110(d)(3) to include providing services for a private placement (rather than just acting as a placement agent).[46] Members' roles in acting as placement agents and in providing other services in private placements (e.g., acting as a finder or a financial advisor) similarly facilitate offerings. As such, expanding the current venture capital exception beyond securities received for acting as a placement agent to include securities received for providing services for a private placement is appropriate.

Where a highly regulated entity with significant disclosure requirements and independent directors who monitor investments is also making a significant co-investment in an issuer and is receiving securities at the same price and on the same terms

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46 See proposed Rule 5110(d)(3) and Item II.C. infra.

as the participating member, the securities acquired by the participating member in a private placement are less likely to be underwriting compensation. To address such co-investments, the proposed rule change would adopt a new venture capital exception from underwriting compensation for securities acquired in a private placement before the required filing date of the public offering by a participating member if at least 15 percent of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that is an open-end investment company not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering. These conditions lessen the risk that the co-investment would be made for the purpose of providing undervalued securities to a participating member in return for acting as an underwriter.

A public offering may be significantly delayed for legitimate reasons (e.g., unfavorable market conditions) and during this delay the issuer may require funding. Furthermore, a member may make bona fide investments in or loans to the issuer during this delay to satisfy the issuer's funding needs and any securities acquired as a result of this funding may be unrelated to the anticipated public offering. The proposed rule change would provide some additional flexibility in the availability of the venture capital exceptions for securities acquired where the public offering has been significantly delayed.

The proposed rule change would take a principles-based approach where a public offering has been significantly delayed and the issuer needs funding in considering whether it is appropriate to treat as underwriting compensation securities acquired by a member after the required filing date in a transaction that, except for the timing, would otherwise meet the requirements of a venture capital exception. This principles-based approach starts with the presumption that the venture capital exception would not be available where the securities were acquired after the required filing date. However, FINRA would consider the factors in proposed Supplementary Material .02 in determining whether securities acquired in a transaction that occurs after the required filing date, but otherwise meets the requirements of a venture capital exception, may be excluded from underwriting compensation.

Specifically, FINRA would consider the following principles, as well as any other relevant factors and circumstances: (1) the length of time between the date of filing of the registration statement or similar document and the date of the transaction in which securities were acquired; (2) the length of time between the date of the transaction in which the securities were acquired and the anticipated commencement of the public offering; and (3) the nature of the funding provided, including, but not limited to the issuer's need for funding before the public offering. A participating member is responsible for providing documents and information sufficient for FINRA to consider in applying the principles to a particular securities acquisition.

Treatment of Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

The proposed rule change would clarify the treatment of non-convertible or non-exchangeable debt securities and derivative instruments.[47] The proposed rule change would expressly provide that non-convertible or non-exchangeable debt securities and

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47 Consistent with the current Rule, the proposed rule change would define the term "derivative instrument" to mean any eligible OTC derivative instrument as defined in Exchange Act Rule 3b-13(a)(1), (2) and (3). See proposed Supplementary Material .06(b) to Rule 5110.

derivative instruments acquired in a transaction unrelated to a public offering would not be underwriting compensation.[48] Accordingly, the non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction unrelated to a public offering would not be subject to Rule 5110 (i.e., a description of the non-convertible or non-exchangeable debt securities and derivative instruments need not be filed with FINRA,[49] there are no valuation-related requirements and the lock-up restriction does not apply).

In contrast, non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to a public offering would be underwriting compensation. For any non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering, the proposed rule change would clarify that: (1) a description of those securities and derivative instruments must be filed with FINRA; and (2) this description must be accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price.[50]

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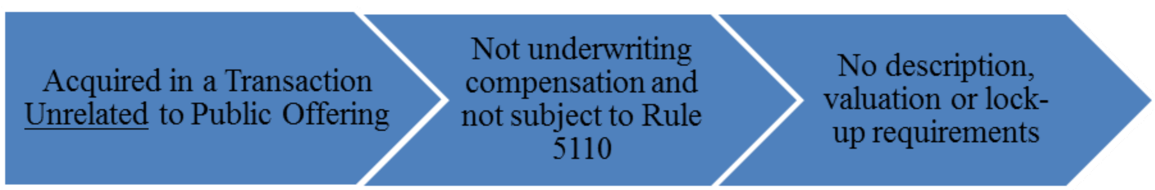
48 See proposed Supplementary Material .01(b)(19) to Rule 5110.

49 See proposed Rule 5110(a)(4)(B)(iv)b.

50 See proposed Rule 5110(a)(4)(B)(iv)a. Generally consistent with current Rule 5110, the proposed rule change would define the term "fair price" to mean the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm's length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. The proposed rule change would also clarify that a derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be

The proposed rule change would also clarify that the valuation depends upon whether the non-convertible or non-exchangeable debt securities or derivative instruments acquired in a transaction related to a public offering were or were not acquired at a fair price. Specifically, the proposed rule change would clarify that non-convertible or non-exchangeable debt securities and derivative instruments acquired at a fair price would be considered underwriting compensation but would have no compensation value. In contrast, the proposed rule change would provide that non-convertible or non-exchangeable debt securities and derivative instruments not acquired at a fair price would be considered underwriting compensation and subject to the normal valuation requirements of Rule 5110.[51]

The following charts provide an overview of the treatment of non-convertible or non-exchangeable debt securities and derivative instruments under Rule 5110.



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entered into or acquired at a fair price. See proposed Supplementary Material .06(b) to Rule 5110.

51 See proposed Supplementary Material .06(a) to Rule 5110 and proposed Rule 5110(c).

Lock-Up Restrictions

Subject to some exceptions, Rule 5110 requires in any public equity offering a 180-day lock-up restriction on securities that are considered underwriting compensation. During the lock-up period, securities that are underwriting compensation 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.[52] Because a prospectus may become effective long before the commencement of sales, the proposed rule change would provide that the lock-up period begins on the date of commencement of sales of the public equity offering (rather than the date of effectiveness of the prospectus).[53] The proposed rule change also would provide that the lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document consistent with proposed Supplementary Material .05 requiring disclosure of the material terms of any securities.[54]

The proposed rule change would add exceptions from the lock-up restriction for clarity or to except securities where other protections or market forces obviate the need for the restriction. Due to the existing public market for securities of the issuers, the proposed rule change would add an exception from the lock-up restriction for securities acquired from an issuer that meets the registration requirements of SEC Registration

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52 Consistent with the current Rule, securities acquired by a member that are not considered underwriting compensation would not be subject to the lock-up restrictions of Rule 5110.

53 See proposed Rule 5110(e)(1)(A).

54 See proposed Rule 5110(e)(1)(B).

Forms S-3, F-3 or F-10.[55] The proposed rule change would also add an exception from the lock-up restriction for securities that were acquired in a transaction meeting one of Rule 5110's venture capital exceptions.[56] While these securities would not be considered underwriting compensation and, thus, not subject to the lock-up restriction, the exception would provide additional clarity with respect to these securities.

The proposed rule change would also add an exception from the lock-up restriction for securities that were received as underwriting compensation and are registered and sold as part of a firm commitment offering.[57] This is intended to give some flexibility to members in selling securities received as underwriting compensation, while limiting the proposed exception to firm commitment offerings where the underwriter has assumed the risk of marketing and distributing an offering that includes securities the underwriter received as underwriting compensation. In addition, firm commitment offers are usually marketed and sold to institutional investors, who typically purchase a majority of the shares in such offerings.

The proposed rule change would provide clarity about the treatment of non-convertible or non-exchangeable debt securities and derivative instruments acquired in transactions related to a public offering.[58] The following charts provide an overview of the application of Rule 5110's lock-up requirement to non-convertible or non-exchangeable debt securities and derivative instruments.

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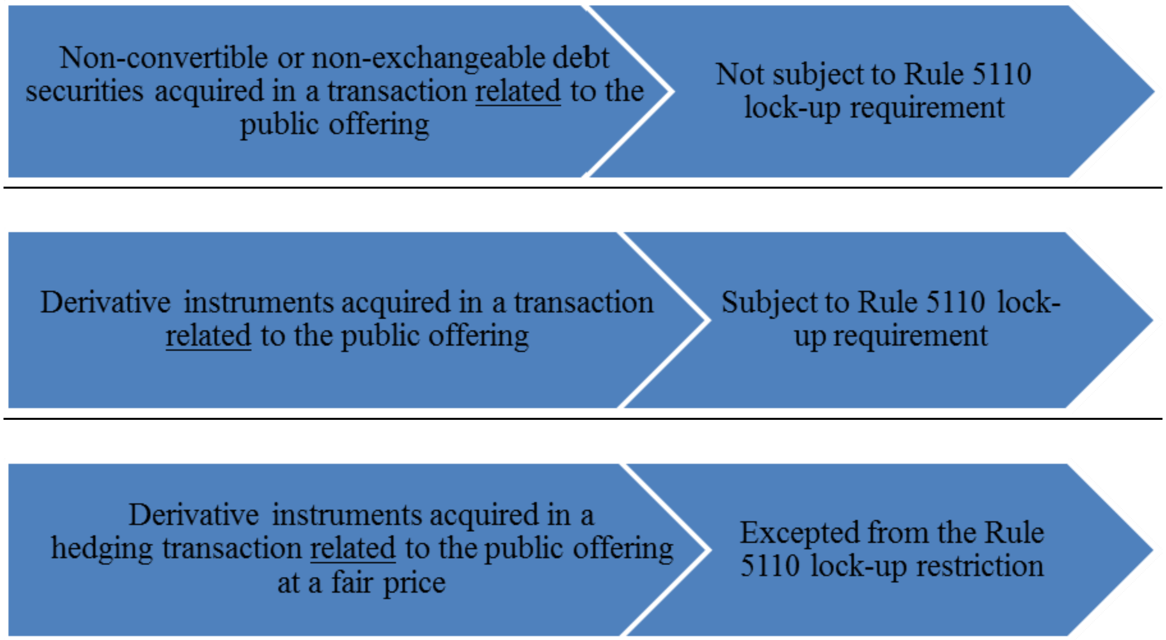
55 See proposed Rule 5110(e)(2)(A)(iii).

56 See proposed Rule 5110(e)(2)(A)(vi).

57 See proposed Rule 5110(e)(2)(A)(viii) and Item II.C. discussion infra.

58 See proposed Rule 5110(e)(2)(A)(iv).



The proposed rule change also addresses members' acquisition of derivative instruments in connection with hedging transactions related to a public offering. For example, fixed-for-floating swaps are commonly used in hedging transactions in connection with offerings of debt securities. These hedging transactions would not be effective if the derivative securities were subject to lock-up restrictions. Accordingly, the proposed rule change would provide that the lock-up restriction does not apply to derivative instruments acquired in connection with a hedging transaction related to the public offering and at a fair price.[59] Derivative instruments acquired in transactions related to the public offering that do not meet the requirements of the exception would continue to be subject to the lock-up restriction.

In addition, the proposed rule change would add an exception to the lock-up restriction to permit the transfer or sale of the security back to the issuer in a transaction

59 See proposed Rule 5110(e)(2)(A)(v).

exempt from registration with the SEC.[60] These transactions do not put selling pressure on the secondary market that the lock-up is designed to prevent. The proposed rule change would also modify the lock-up exception in current Rule 5110(g)(2)(A)(ii) to permit 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.[61]

Finally, because proposed Supplementary Material .01(b)(20) would provide that securities acquired subsequent to the issuer's IPO in a transaction exempt from registration under Securities Act Rule 144A would not be underwriting compensation, the proposed rule change would correspondingly delete as unnecessary the current exception from the lock-up restriction for those securities.[62]

Prohibited Terms and Arrangements

Rule 5110 includes a list of prohibited unreasonable terms and arrangements in connection with a public offering of securities. The proposed rule change would clarify and amend the list, such as clarifying the scope of relevant activities that would be deemed related to the public offering[63] and referring to the commencement of sales of the

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60 See proposed Rule 5110(e)(2)(B)(iii).

61 See proposed Rule 5110(e)(2)(B)(i). The proposed rule change 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. See proposed Rule 5110(e)(2)(B)(ii).

62 See current Rule 5110(g)(2)(A)(viii).

63 See proposed Rule 5110(g)(11). Specifically, to clarify the scope, the proposed rule change would refer to "solicitation, marketing, distribution or sales of the offering" rather than the current "distribution or assisting in the distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting."

public offering (rather than the date of effectiveness) in relation to the receipt of underwriting compensation consisting of any option, warrant or convertible security with specified terms.[64]

The proposed rule change would also clarify that it would be considered a prohibited arrangement for any underwriting compensation to be paid prior to the commencement of sales of public offering, except: (1) an advance against accountable expenses actually anticipated to be incurred, which must be reimbursed to the issuer to the extent not actually incurred; or (2) advisory or consulting fees for services provided in connection with the offering that subsequently is completed according to the terms of an agreement entered into by an issuer and a participating member.[65] The proposed rule change recognizes the practical issue that certain fees and expenses, including advisor or consultant fees, may be incurred before the offering is sold and allows such fees so long as the services are in connection with an offering that is completed in accordance with the agreement between the issuer and the participating member.

The proposed rule change would also simplify a provision that relates to payments made by an issuer to waive or terminate a ROFR to participate in a future capital-raising transaction.[66] The application of this provision has been challenging for members, particularly in circumstances where the terms of the future offering had not been negotiated at the time of the proposed public offering. The proposed rule change would,

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64 See proposed Rule 5110(g)(8).

65 See proposed Rule 5110(g)(4).

66 See current Rule 5110(f)(2)(F)(i).

however, retain the prohibition on any non-cash payment or fee to waive or terminate a ROFR.[67]

Defined Terms

In addition to consolidating the defined terms in one location at the end of the Rule, the proposed rule change would simplify and clarify Rule 5110's defined terms. Most notably, the proposed rule change would make the terminology more consistent throughout the Rule's various provisions. For example, the proposed rule change would consolidate the various provisions of the current Rule that address what constitutes underwriting compensation into a single, new definition of "underwriting compensation."[68]

The proposed rule change would also add consistency and clarity 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)[69] 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).[70] The proposed rule change would eliminate the term "underwriter and related persons" and instead use the defined term "participating member." However, the proposed definition of

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67 See proposed Rule 5110(g)(7).

68 See proposed Rule 5110(j)(22).

69 See current Rule 5110(a)(6).

70 See current Rule 5110(a)(4).

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's fees).[71]

The proposed rule change would move the definition of "public offering" from Rule 5121 to Rule 5110.[72] The term "public offering" is used frequently in Rule 5110 and moving it into the Rule should simplify compliance. The definition would be modified to add "made in whole or in part in the United States" to clarify the jurisdictional scope of the definition. The proposed rule change would also move, without modification, the definition of "Net Offering Proceeds" from Rule 5110 to Rule 5121 because the term is used only in Rule 5121.[73]

In addition, the proposed rule change would modernize Rule 5110's language (e.g., by replacing references to specific securities exchanges to instead reference the

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71 Substantively consistent with the current Rule, the proposed rule change 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," but does not include the issuer. See proposed Rule 5110(j)(15). 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's 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." In addition, the term "immediate family" is clarified for readability in proposed Rule 5110(j)(8) to mean the spouse or child of an associated person of a member and any relative who lives with, has a business relationship with, or provides to or receives support from an associated person of a member.

72 See proposed Rule 5110(j)(18). Rule 5121 would incorporate the definition in Rule 5110 by reference. See Rule 5121(f).

73 See proposed Rule 5121(f)(9).

definition of "national securities exchange" in the Exchange Act). Furthermore, the proposed rule change would include new defined terms to provide greater predictability for members in applying the Rule (e.g., "associated person," "experienced issuer,"[74] "equity-linked securities," "overallotment option" and "review period").

The proposed rule change would incorporate the definition of "associated person" in Article I, Section (rr) of the FINRA By-Laws. In response to comments on the Notice 17-15 Proposal, the proposed rule change would also harmonize the definition of bank in the proposed venture capital exceptions and the exemption in proposed Rule 5110(h)(1). Specifically, the proposed rule change would state that a bank is "a bank as defined in Exchange Act Section 3(a)(6) or is a foreign bank that has been granted an exemption under this Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates." In addition, in response to comments and to clarify the scope of covered persons, the proposed rule change would revise the issuer definition to refer to the "registrant or other person" (rather than "entity" as initially proposed in the Notice 17-15 Proposal).

Valuation of Securities

Rule 5110 currently prescribes specific calculations for valuing convertible and non-convertible securities received as underwriting compensation. Rather than the

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[74] As discussed supra, the proposed rule change 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 or more 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. See proposed Rule 5110(j)(6).

specific calculations in the current Rule, the Notice 17-15 Proposal would have instead allowed 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). As discussed in Item II.C. infra, commenters had conflicting views on the proposed change to the valuation formula and did not provide any information regarding alternative commercially available valuation methods that may be used by members. As a result, the proposed rule change would retain the current methods for valuing options, warrants and other convertible securities received as underwriting compensation in the current Rule.[75]

If the Commission approves the proposed rule change, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[76] 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.

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75 See proposed Rule 5110(c).

76 15 U.S.C. 78o-3(b)(6).

The proposed rule change would facilitate capital formation by modernizing Rule 5110. The proposed rule change would simplify the provisions of the Rule, make it more comprehensible, and improve its administration.

For example, the proposed rule change is expected to clarify what is considered "underwriting compensation." In addition, the proposed rule change would make the venture capital exceptions more available to members and not impinge on bona fide investments in, and loans to, issuers. In general, the proposed rule change would provide members with greater operational and financial flexibility, and reduce compliance costs.

The proposed rule change would maintain important protections for issuers and investors participating in offerings. The proposed rule change also would not decrease its ability to oversee underwriting terms and arrangements.

In totality, the proposed rule change would reduce the administrative and operational burdens for members and FINRA, promote regulatory efficiency, and enhance market functioning while maintaining issuer and investor protection.

B. <u>Self-Regulatory Organization's Statement on Burden on Competition</u>

FINRA does not believe that the proposed rule change would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. All members would be subject to the proposed amendments.

<u>Economic Impact Assessment</u>

FINRA considered the economic impacts on members when devising the proposed rule change. A discussion of the economic impacts is below.

Regulatory Need

Rule 5110 was last revised in 2004, and since then the capital markets and financial activities of member firms have continued to evolve.[77] The proposed change would modernize Rule 5110 through a range of amendments. The proposed change would simplify and clarify the Rule, and better align the Rule with current market practices.

Economic Baseline

The economic baseline for the proposed rule change is current Rule 5110 and its interpretation by FINRA. The proposed rule change is expected to affect participating members, issuers and investors that participate in public offerings.

Rule 5110 regulates the underwriting terms and arrangements in connection with the public offering of securities. The primary function of the Rule is to protect issuers (and their investors at the time of the offering) from unfair underwriting terms and arrangements. Unfair underwriting terms and arrangements increase the costs to issuers of raising capital, potentially leading to a less efficient allocation of capital and thereby imposing a restriction on issuers that need to access capital markets.

The Rule also provides protections for issuers and investors through lock-up restrictions. The restrictions reduce the ability of participating members to utilize the information they gather as part of the underwriting process to opportunistically sell the securities they acquire as compensation in the secondary market (i.e., informed selling).[78]

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[77] See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

[78] Participating members may have greater ability to engage in informed selling soon after the commencement of sales when they may have additional

The lock-up restrictions thereby decrease the likelihood that participating members use the securities to extract undue compensation from issuers, and decrease the likelihood that investors in the secondary market purchase securities when the securities are overvalued. The exposure of investors to informed selling decreases as time elapses and more information about the issuer becomes available.

Member firms that participate in offerings, however, incur costs to comply with Rule 5110. The costs to members include filing and disclosure requirements, limits to direct and indirect compensation, and restrictions on financial and investment activities. These costs decrease the return to members when participating in offerings.

Rule 5110 requires participating members to file documents and information with FINRA. FINRA reviews the information to determine whether underwriting terms and arrangements meet the requirements of the Rule. To the extent possible, this economic impact analysis will quantify the economic effects of the proposed rule change using the information that FINRA collects through its administration of Rule 5110. The analysis will otherwise discuss the economic effects qualitatively.

In 2017, FINRA received 1,553 filings related to public offerings (covering both equity and debt securities). The filings represent at least 274 members and 1,071 issuers. The total amount of offering proceeds of the filings were over $151 billion, with a median value of approximately $38 million per filing.[79]

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information than other market participants. As more information becomes publicly available, the ability of participating members to engage in informed selling decreases.

[79] The 1,553 filings include shelf offerings. FINRA does not require filing, in all cases, the total amount of offering proceeds related to these filings.

Currently, members that participate in fewer offerings are likely to incur higher marginal costs to interpret and comply with Rule 5110. In 2017, the median number of filings in which a member participated was three. This means that approximately half of the members (148 of 274 members) participated in three or fewer offerings. In addition, a large number of these members (85) participated in only one offering.[80]

Economic Impact

The proposed amendments would directly impact member firms that regularly engage in underwriting, issuers that engage member firms for those services, and the investors that seek to participate in those offerings. This economic impact analysis seeks to identify the broad impacts associated with modernizing Rule 5110, as well as specific amendments related to the acquisition of securities, lock-up restrictions, filing requirements, and exemptions for offerings that relate to highly regulated entities.

Modernization

Overall, the proposed change would modernize Rule 5110 by simplifying and clarifying its provisions, and by increasing the consistency of the Rule with current practice. The simplification and clarification of the Rule would decrease the compliance costs of member firms that participate in offerings. The decrease in compliance costs includes the time and expense of internal employees to interpret the Rule, as well as the potential expenses associated with outside legal counsel or other outside experts. The simplification and clarification would also decrease the opportunity costs to participating members from not acquiring securities so as to not violate the permitted compensation

[80] In addition, approximately one-quarter of members (71) participated in ten or more offerings, whereas ten percent of members (27) participated in 50 or more offerings. The maximum number of offerings that any one member participated in was 155.

arrangements under the Rule. Members that participate in fewer offerings would experience a greater decrease in marginal costs from the proposed rule changes.

As a result of the simplification and clarification of Rule 5110, the underwriting terms and arrangements members negotiate with issuers are more likely to be in compliance with the Rule, and the documents and information members file with FINRA are more likely to meet the regulatory requirements of the rule. This may decrease the amount of time that FINRA needs to evaluate the underwriting terms and arrangements and provide an opinion. A decrease in the time needed for FINRA to provide an opinion could potentially enhance the ability of issuers to access capital markets faster provided the concurrent review conducted by the SEC staff has concluded and an offering can be declared effective.

Securities Acquisitions Not Considered Underwriting Compensation

The proposed rule change addresses whether the securities and derivative instruments that participating members acquire are considered underwriting compensation. The amendments relate to securities acquired from third parties for purposes unrelated to underwriting compensation, investments or loans to the issuer when a public offering has been significantly delayed, and non-convertible or non-exchangeable debt securities and derivative instruments unrelated to a public offering.[81] The amendments also broaden two current venture capital exceptions, and adopt a new venture capital exception.[82]

81 See proposed Supplementary Material .02, .03, .04, and .06 to Rule 5110.

82 See proposed Rule 5110(d)(1), (2), and (4). Among the 1,553 filings FINRA received relating to public offerings in 2017, 17 (one percent of 1,553) relate to the current venture capital exceptions under 5110(d)(5).

In general, the proposed rule change would provide participating members additional flexibility and clarity with respect to whether the securities and derivative instruments they acquire would be subject to the compensation limits and lock-up restrictions of Rule 5110. The proposed rule change would therefore decrease the constraints on participating members to engage in transactions in the ordinary course of business and obtain the commissions and trading profits therefrom. The proposed rule change would also decrease the constraints on participating members to engage in hedging transactions and thereby manage their risk exposures.

The venture capital exceptions would increase the total percentage of shares that participating members may acquire without being considered underwriting compensation under Rule 5110, and as a result may increase the number of members that participate in an offering. The proposed amendments to the venture capital exceptions, therefore, would increase the number of financial options and amount of capital available for issuers. The proposed amendments may also improve the market for offerings.[83] The venture capital exceptions would thereby promote capital formation.

Conversely, the proposed amendments to the venture capital exceptions allowing underwriters to acquire additional securities not considered underwriting compensation may increase potential conflicts of interest. These acquisitions may create a control

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[83] See Shane A. Corwin & Paul Shultz, The Role of IPO Underwriting Syndicates: Pricing, Information Production, and Underwriter Competition, 60(1) Journal of Fin. 443-486 (2005). The authors find that larger syndicates increase information production, analyst coverage, and the number of market makers following the offering.

relationship, potentially resulting in a participating member having a conflict of interest and increasing the costs to issuers and investors.[84]

Two requirements, however, serve to mitigate against these potential costs to issuers. FINRA Rule 5121 specifically addresses the conflicts of interest of participating members and requires disclosure of the conflicts. Further, the proposed amendments also include a requirement that the securities participating members acquire is at the same price and with the same terms as the securities purchased by all other investors. This is intended to ensure that the securities participating members acquire are not for providing undervalued securities as a form of underwriting compensation.

An increase in the percentage of shares that participating members acquire that is not subject to Rule 5110 may also impose costs on investors. The securities and derivative instruments that participating members acquire would not be subject to lock-up restrictions, and may increase the exposure of investors in the secondary market to informed selling. As described in further detail below and subject to some exceptions, the proposed rule change would decrease investor exposure to informed selling by amending the lock-up restrictions under the Rule.

Lock-up Restrictions

The proposed rule change would specify that, consistent with current practice, the lock-up period begins on the date of commencement of sales instead of the date of effectiveness of the prospectus.[85] This would ensure that at least 180 days must pass after

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[84] One commenter expressed concern that removing the restriction in current Rule 5110(d)(5)(A) and (B) may increase the potential for conflicts of interest to arise. See NASAA.

[85] See proposed Rule 5110(e)(1)(A).

the commencement of sales before participating members may sell the securities that they receive as underwriting compensation. This amendment would only impose economic effects on offerings that otherwise would have begun the lock-up period on the date of the effectiveness of the prospectus. For these offerings, investors would have a longer exposure to informed selling from the date of the commencement of sales, and participating members would have a longer exposure to fluctuations in security values from the date of the commencement of sales. In the experience of FINRA staff, however, any longer exposure would be minimal.

The proposed rule change would provide exceptions to the lock-up restrictions.[86] Although the exceptions to the lock-up restrictions would provide flexibility and reduce the investment risk of participating members, the exceptions may also increase the exposure of investors to informed selling. The scope of the proposed exceptions, however, reduce the likelihood that investors purchasing the securities would be at an informational disadvantage. One exception is for securities acquired from an issuer that meet the registration requirements of SEC Registration Forms S-3, F-3 or F-10. These registration requirements relate to issuers with existing public markets for their securities. Other proposed exceptions to the lock-up provisions are for sales as part of a firm commitment offering (which are usually marketed and sold to institutional investors) and sales back to the issuer.[87]

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[86] See proposed Rule 5110(e)(2)(A)(iii) and (viii), and (B)(iii).

[87] Among the 1,553 filings FINRA received relating to public offerings in 2017, 778 relate to firm commitment offerings. The proceeds of the offerings were over $110 billion, or approximately three-quarters of the total proceeds relating to all filings. The median proceeds were $60 million. The largest maximum proposed offering proceeds registered was $2.7 billion. Information describing issuers that

Filing Requirements

In general, the proposed rule change would decrease or streamline the filing requirements of participating members. For example, unless otherwise required by FINRA, participating members would not be required to provide documents relevant to the underwriting terms and arrangements if industry-standard master forms of agreement are used. In addition, participating members would not be required to submit amendments to previously filed documents unless the changes impact the underwriting terms and arrangements.[88] The decrease in filing requirements would decrease the compliance costs of participating members. The costs for members include the time and expense of legal counsel and other internal staff to prepare and submit the filings.

The proposed changes in filing requirements would decrease the documents and information that participating members file with FINRA. FINRA does not believe, however, that the decrease in the documents and information it receives would reduce its ability to evaluate underwriting terms and arrangements and provide protections to issuers and investors. The documents and information are often duplicative or otherwise unnecessary, or can be accessed through other means.[89]

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meet the registration requirements of SEC Registration Forms S-3, F-3 or F-10 or sales back to the issuer is not available.

88 See proposed Rule 5110(a)(4)(A) and (E).

89 For example, proposed Rule 5110(a)(4)(E) would streamline the filing requirements for shelf offerings. A participating member would file the Securities Act registration number, and the documents and information set forth in proposed Rule 5110(a)(4)(A) and (B) only if specifically requested by FINRA. Otherwise, FINRA would access the base shelf registration statement, amendments, and prospectus supplements through the SEC's EDGAR system to conduct the review.

In some instances, however, the proposed rule change would increase the filing requirements of participating members. For example, a new provision would require participating members of terminated offerings to provide written notification of all underwriting compensation received or to be received.[90] The new requirements would increase the costs to participating members to file documents and information with FINRA. The new requirements, however, would increase the ability of FINRA to oversee underwriting terms and arrangements, and provide protections to issuers and investors.

Exemptions for Highly Regulated Entities

Lastly, the proposed rule change would expand the current list of offerings that are exempt from its filing requirements and its substantive provisions.[91] The offerings relate to highly regulated entities whose offering terms would continue to be subject to FINRA Rule 2341. The regulatory protections for issuers and investors would therefore remain, but participating members would no longer incur the costs to comply with Rule 5110.

Offerings that are subject only to FINRA Rule 2341 are not required to be filed with FINRA. In the experience of FINRA staff, however, few filings currently made pursuant to Rule 5110 are also subject to Rule 2341. FINRA therefore does not expect that the costs and benefits of the proposed amendments relating to these offerings would be material.

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[90] See proposed Rule 5110(a)(4)(C) and proposed Rule 5110(g)(5).

[91] See proposed Rule 5110(h)(2)(E), (K), and (L). The proposed Rule would also clarify that securities of banks that have qualifying outstanding debt securities are exempt from the filing requirement. See proposed Rule 5110(h)(1)(A).

Alternatives Considered

FINRA considered several alternatives in developing the proposed rule change. FINRA explored how to modernize the Rule and how to simplify and clarify its provisions, while maintaining the protections for issuers and investors.

One alternative to the proposed rule change would be to modify or eliminate the filing requirement for shelf-offerings by issuers that do not meet the "experienced issuer" standard.[92] Although a modification or elimination of the filing requirement would decrease the compliance costs of participating members, it could increase the exposure of these issuers to unfair and unreasonable underwriting terms and arrangements. FINRA believes that the decrease in compliance costs under this alternative would not justify the increased risk of harm to issuers.

A second alternative would allow participating members to value options, warrants, and other convertible securities they receive as underwriting compensation with common or commercially available valuation methods. The alternative methods could increase the accuracy of the valuations but also their variability across offerings and members. The alternative valuation methods could reduce the ability of issuers and participating members to agree to terms and the ability of FINRA staff to evaluate the underwriting terms and arrangements, and thereby increase the amount of time for issuers to access capital markets.[93] FINRA will therefore retain the current valuation methods.

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92 See, e.g., ABA and Sullivan.

93 Commenters to the Notice 17-15 Proposal also had conflicting views on the proposed change to the valuation formula, and did not provide any information regarding commercially available valuation methods. See, e.g., NASAA and SIFMA.

A third alternative, which was proposed in the Notice 17-15 Proposal, would no longer require the disclosure of the dollar amount ascribed to each individual item of underwriter compensation in the prospectus. Instead, participating members could aggregate the underwriting expenses for all items, except for the discount or commission. This alternative would have decreased the compliance costs of participating members. It could have also decreased the ability of investors to understand the underwriting terms and arrangements, however, and to decide whether to participate in the offerings.[94]

Other alternatives include different thresholds relating to the proposed amendments to the venture capital exceptions.[95] An increase in the amount of securities that participating members may acquire before triggering the provisions of the Rule would benefit issuers by increasing the number of members available to participate in private placements and subsequent public offerings. However, broader exceptions may reduce issuer and investor protections if more activities that are potentially not underwriting compensation are not governed by these provisions of Rule 5110. The proposed rule change maintains several restrictions to ensure the protection of other market participants, including issuers and investors, and is justified by its benefits including the further promotion of capital formation.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in the Notice 17-15 Proposal. FINRA received 11 comment letters in response to the Notice 17-15 Proposal.

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94 Commenters to the Notice 17-15 Proposal had conflicting views on the proposed change to the disclosure of each individual item of underwriter compensation. See, e.g., ADISA and NASAA.

95 See proposed Rule 5110(d).

A copy of the Notice 17-15 Proposal is attached as Exhibit 2a. Copies of the comment letters received in response to the Notice 17-15 Proposal are attached as Exhibit 2c.[96]

FINRA has considered the concerns raised by commenters and, as discussed in detail below, has addressed many of the concerns noted by commenters in response to the Notice 17-15 Proposal. The comments and FINRA's responses are set forth in detail below.

General Support and Opposition to the Notice 17-15 Proposal

Four commenters supported FINRA's efforts to simplify, clarify and modernize Rule 5110 but did not support all aspects of the Notice 17-15 Proposal.[97] SIFMA supported some aspects of the Notice 17-15 Proposal but suggested retooling Rule 5110 to a more disclosure-focused and principles-based approach. Callcott supported amending Rule 5110 to require only disclosure of financial relationships between a broker-dealer and its client in a securities underwriting. The remaining commenters expressed comments to several specific aspects of the Notice 17-15 Proposal as discussed below.

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Since 1992, Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in public offerings of securities. Rule 5110 continues to play an important role in ensuring investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

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96 See Exhibit 2b for a list of abbreviations assigned to commenters.

97 See ABA, NASAA, Rothwell and Sullivan.

The proposed rule change strikes an appropriate balance in modernizing Rule 5110 to allow for some flexibility where appropriate, while maintaining important protections. For instance, one area where FINRA is proposing to add some flexibility is to incorporate a limited principles-based approach to be used by FINRA in determining whether some securities acquisitions may be excluded from underwriting compensation. Specifically, the proposed rule change would incorporate a principles-based approach for acquisitions of securities in venture capital transactions where there has been a significantly delayed offering, acquisitions of issuer securities from third parties and acquisitions of securities pursuant to an issuer's directed sales program. The proposed rule change would retain Rule 5110's current objective approach for other securities acquisitions.

Callcott stated that Rule 5110's complexity imposes costs on all public underwritings and serves as an incentive to instead conduct private placements or other transactions. Moreover, Callcott stated that because "troubled" public companies present the highest liability risks for underwriters, underwriters are unwilling to assist those companies unless they are adequately compensated for the risk. Callcott suggests that Rule 5110 does not solve the problem of "small troubled" companies in need of financing; rather, Callcott states the Rule simply moves the problem to a largely non-transparent and unregulated alternative financial environment, to the significant detriment of companies and their investors.

The application of Rule 5110 to the receipt of underwriting compensation does not represent a material detriment to small firms or a disincentive to small firm IPOs. Rather, the decrease in small firm IPOs is a multi-faceted issue that may be caused by several factors (e.g., the availability of alternative financing or industry consolidation). Moreover, the availability of different sources of financing may be beneficial to some small firms. It is unclear how removing Rule 5110's restrictions on underwriting terms and arrangements, and corresponding restrictions on underwriting compensation, would be a net positive for "small troubled" companies in need of financing.

Filing Requirements

Three commenters supported allowing members more time to make the required filings with FINRA (from one business day after filing with the SEC or a state securities commission or similar state regulatory authority to three business days) and agreed that the change would help with logistical issues or inadvertent delays without impeding FINRA's ability to review the underwriting terms and arrangements.[98] ABA supported proposed Rule 5110(a)(4)(A)(ii) to expressly provide that standard industry forms are not required to be filed in connection with an offering, unless otherwise specifically requested by FINRA.

SIFMA suggested FINRA clarify that the requirement in proposed Rule 5110(a)(1)(B) that the managing underwriter notify the other members if the underwriting terms and arrangements are unfair and unreasonable and not appropriately modified be limited to situations where FINRA has made such determination with respect to the terms and arrangements and has so notified the managing underwriter. FINRA agrees and made the suggested change as discussed above in proposed Rule 5110(a)(1)(B).

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98 See ABA, ADISA and SIFMA.

ABA suggested that the Rule should permit reliance on filings made by issuers in proposed Rule 5110(a)(3)(B) or, alternatively, if not retained, the availability of such reliance should be clarified in Supplementary Material to Rule 5110. Participating members are responsible for filing the required documents and information with FINRA. 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 any documents and information as set forth in proposed Rule 5110(a)(4)(A) and (B) if specifically requested by FINRA regarding the takedown once the participating member has been engaged.

Commenters requested clarifying or deleting the Notice 17-15 Proposal's requirement to file amendments to any documents that contain "changes to the offering" in proposed Rule 5110(a)(4)(A)(iii) to narrow the filing requirement to changes relating to the disclosures made or to be made in any filing that impact the underwriting terms and arrangements for the offering.[99] The commenters suggested that narrowing the scope of proposed Rule 5110(a)(4)(A)(iii) would appropriately capture the documents relevant to FINRA's review and would reduce the burdens on members (and the associated time and cost) to make unnecessary administrative filings.

FINRA agrees with the commenters and proposes to narrow the filing requirement to changes that "impact the underwriting terms and arrangements for the public offering." Examples of changes impacting the underwriting terms and arrangements include, but are not limited to, changes to the size of the offering, the method of distribution (i.e., firm commitment or best efforts), the amount of underwriting

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99 See ABA, ADISA, Davis Polk, Rothwell and SIFMA.

compensation, the type of underwriting compensation, and any new termination fee or ROFR that survives termination of the offering.

Two commenters supported the change in proposed Rule 5110(a)(4)(B)(iii) relating to the representation as to the association or affiliation between participating members and beneficial owners of 5 percent or more of "any class of the issuer's securities" to instead refer to beneficially owning 5 percent or more of any class of the issuer's "equity or equity-linked securities."[100] SIFMA also supported the proposed elimination of the requirement currently in Rule 5110 to provide a representation as to the association or affiliation between participating members and "any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering." SIFMA suggested that the narrower focus is appropriately designed to elicit the most useful information for reviewing relationships that may affect the underwriting terms and arrangements.

ABA requested guidance with respect to the representation requirement in proposed Rule 5110(a)(4)(B)(iii) where beneficial owners of 5 percent or more of any class of the issuer's equity securities are funds or other types of investment vehicles, which are usually in the form of limited partnerships or limited liability companies. ABA also requested that the representation be limited to a statement of association or affiliation only with respect to the general partner or investment manager of such fund or investment vehicle, and any limited partner beneficially owning more than 25 percent of the limited partnership or limited liability company membership interests of the fund or investment vehicle.

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100 See ABA and SIFMA.

Although application of Rule 5110's requirements to beneficial ownership by funds or other types of investment vehicles historically has not been problematic, there have been some instances where conflicts have been identified. When questions have arisen related to beneficial ownership by funds or other types of investment vehicles, FINRA has been willing to work with members to address the questions raised by particular structures and arrangements. Rather than amending the Rule, FINRA proposes to retain the flexibility afforded by this established approach because beneficial ownership of 5 percent or more of an issuer's securities may result in conflicts of interest.

SIFMA suggested that proposed Rule 5110(a)(4)(B)(iv) – requiring the filing of a "description of any securities of the issuer acquired and beneficially owned by any participating member during the review period" – should be limited to a description of any securities-based underwriting compensation acquired during the review period by the participating member (i.e., no description for securities that do not constitute underwriting compensation). Limiting the description to securities that the participating member has determined would be underwriting compensation could result in an incomplete picture of the underwriting terms and arrangements. A description of any issuer securities acquired and beneficially owned by the participating member during the review period is needed to fully evaluate the underwriting terms and arrangements of the public offering and to ensure that there is no circumvention of the Rule.

While a complete description would be required, the proposed rule change provides flexibility with respect to whether some securities would be treated as underwriting compensation under Rule 5110. For example, because FINRA recognizes that some acquisitions of issuer securities from third parties are for purposes unconnected to underwriting compensation, the proposed rule change would incorporate a principles-based approach in considering whether securities of the issuer acquired from third parties may be excluded from underwriting compensation.

Given the strict limitations on the receipt of underwriting compensation in terminated offerings imposed by proposed Rule 5110(g)(5), SIFMA suggested deleting the requirement in proposed Rule 5110(a)(4)(C) for a member to file a written notification to FINRA of all underwriting compensation received or to be received pursuant to proposed Rule 5110(g)(5), including a copy of any agreement governing the arrangement if an offering is terminated. SIFMA suggested that at the very least, if the requirement is retained, the requirement should be limited to notice to FINRA with respect to the receipt of termination fees. ABA also did not support the requirement in proposed Rule 5110(a)(4)(C) and suggested that the lack of an end date for the requirement would lead to confusion. ABA suggested that, if the requirement is retained, FINRA should clarify the purpose of the obligation, confirm that any such payments are tied to the original failed offering and not a successful subsequent offering, and provide a sunset provision for the requirement.

FINRA believes that information regarding underwriting compensation received or to be received in terminated offerings is relevant to its evaluation of compliance with Rule 5110 and, in particular, paragraph (g)(5). Moreover, incorporating a sunset provision into proposed Rule 5110(a)(4)(C) could result in intentionally delaying payment of underwriting compensation until after the sunset date to circumvent the requirements of Rule 5110. Accordingly, the proposed rule change would retain the approach in the Notice 17-15 Proposal.

Davis Polk requested clarification regarding whether information relating to unvested securities acquired by participating members during the review period must be filed under Rule 5110. Davis Polk suggested that these securities should not constitute underwriting compensation, as it is unclear whether the conditions precedent to vesting will ever be satisfied. As noted above, it is important that FINRA have information on all securities received during the review period in order to more accurately evaluate the levels of underwriting compensation. When considering whether vested or unvested securities acquired by participating members and their associated persons are underwriting compensation FINRA evaluates why the securities were granted. For example, unvested directors' options granted to associated persons of participating members in excess of what other directors receive would be deemed underwriting compensation, but grants that are comparable to what other directors receive would not be underwriting compensation.

Filing Requirements for Shelf Offerings

SIFMA suggested modifying the exemption in proposed Rule 5110(h)(1)(C) to eliminate the requirement that issuers filing offerings on Form S-3 need to satisfy the pre-1992 Form S-3 standards or, alternatively, to provide a filing exemption for offerings by well-known seasoned issuers ("WKSIs") that meet current Form S-3 standards. Sullivan suggested exempting all offerings of securities registered on Forms S-3 and F-3 from both the Rule's substantive and filing requirements and, at a minimum, exempting WKSIs from Rule 5110. In light of established market practices, Sullivan believes that these issuers do not need FINRA's protection in the negotiation of underwriting terms and arrangements and that FINRA's oversight is an unnecessary speed bump to these issuers accessing the capital markets. Davis Polk questioned whether FINRA's goal of investor protection is furthered by the requirement to file WKSI offerings and suggested that FINRA's goal should be to make access to capital less expensive.

Given the availability of documents on the SEC's EDGAR system, Davis Polk suggested eliminating the requirement to file with FINRA prospectus supplements and underlying documents for shelf offerings subject to Rule 5110's filing requirements. Davis Polk suggested that member's counsel should instead be required, at the time of filing of the registration statement, to obtain representations from members that: (1) underwriting compensation will not exceed 8 percent of the gross offering proceeds; and (2) members will not engage in any prohibited arrangements in connection with any takedown from the base shelf registration statement.

As discussed in Item II.A., given the regulatory issues that have previously arisen in shelf offerings, the proposed rule change would continue to apply Rule 5110's filing requirement to shelf offerings by issuers that do not meet the "experienced issuer" standard. However, to facilitate the ability of issuers to take advantage of favorable market conditions on short notice and to quickly raise capital through takedown offerings, the proposed rule change would streamline the filing requirements for shelf offerings by issuers that do not meet the "experienced issuer" standard. Specifically, with respect to these shelf offerings, the proposed rule change would provide that only the following documents and information must be filed: (1) the registration statement number; and (2) if specifically requested by FINRA, other documents and information set forth in proposed Rule 5110 (a)(4)(A) and (B).

FINRA would access the base shelf registration statement, amendments and prospectus supplements in the SEC's EDGAR system and populate the information necessary to conduct a review in the FINRA System. Upon filing of the required registration statement number and documents and information, if any, that FINRA requested pursuant to proposed Rule 5110(a)(4)(E), FINRA would provide the no objections opinion. To further facilitate issuers' ability to have quicker access to capital markets, FINRA's review of documents and information related to a shelf takedown offering for compliance with Rule 5110 would occur on a post-takedown basis.

Davis Polk suggested adding an exemption to the filing requirement for any offering on Forms S-3 and F-3 or any IPO: (1) of an issuer controlled by a venture capital or private equity fund with $100 million in assets under management; or (2) with proceeds of $75 million or more. Davis Polk stated that the filing requirement is not needed as these issuers are sophisticated professional negotiators and investors have immediate access to company disclosures through EDGAR, issuer websites and third party analysis. Alternatively, Davis Polk recommended that the proposed exemption for shelf offerings be revised to reflect, at a minimum, the Oct. 21, 1992 Form S-3 and F-3 eligibility requirement of a public float of $75 million or, preferably, to eliminate the public float requirement entirely, in accordance with current Form S-3 and F-3 standards. Davis Polk suggested that the requirement in the exemption that the issuer have reported under the Exchange Act for three years be modified to one year, as is the case with current Forms S-3 and F-3, on the grounds that a three year reporting history does not provide any benefit because technology provides investors with immediate access to information.

As discussed above, the proposed rule change would significantly reduce the filing obligations for shelf offerings. The underwriting terms and arrangements in IPOs of issuers controlled by venture capital or private equity funds or IPOs with proceeds of $75 million or more are not significantly different from those in other IPOs and FINRA's filing and review program is necessary for investor protection.

Exemptions from Filing and Substantive Requirements

Commenters suggested several changes to the proposed exemptions from Rule 5110's filing requirement or substantive provisions to expand, modify or clarify the exemptions. Three commenters recommended not subjecting to Rule 5110's filing requirement public offerings that otherwise meet a filing exemption but for participation by a QIU pursuant to Rule 5121.[101] The commenters suggested that subjecting these offerings to Rule 5110's filing requirement is unjustified and unwarranted, increases the issuer's transaction costs, and alters the composition of underwriting syndicates in ways that do not further investor or market protection.

Consistent with the approach in the current Rule, proposed Rule 5110(h)(1) would require filing these offerings only if there is participation by a QIU. Rule 5121 was amended in 2009 to focus on offerings with significant conflicts of interest that require the participation of a QIU.[102] FINRA has a regulatory interest in reviewing offerings in which a member has a significant conflict of interest requiring the participation of a QIU.

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[101] See ABA, Davis Polk and SIFMA.

[102] See Securities Exchange Act Release No. 60113 (June 15, 2009), 74 FR 29255 (June 19, 2009) (Order Approving File No. SR-FINRA-2007-009). See also Regulatory Notice 09-49 (August 2009).

Accordingly, filing and review of these offerings under Rule 5110 continues to be appropriate.

ABA requested revising the exemption from the filing requirement in proposed Rule 5110(h)(1)(E)(i) for exchange offers to include situations in which the securities to be acquired in the exchange are convertible into securities that are listed on a national securities exchange as defined in Section 6 of the Exchange Act. FINRA believes extension of the exemption to these convertible securities is unlikely to be problematic for market participants. Accordingly, the proposed rule change would expand proposed Rule 5110(h)(1)(E)(i) to exempt from the filing requirement exchange offers where the securities to be issued or the securities of the company being acquired are listed, or convertible into securities that are listed, on a national securities exchange as defined in Section 6 of the Exchange Act.

ABA suggested that in many cases the role played by a member acting as a distribution manager in connection with an exchange offer is limited to contacting investors and recording their intention to tender and that the member receives nominal compensation for these services. Accordingly, ABA requested exempting from Rule 5110's filing requirement exchange offers in which the compensation to be received by the distribution manager does not exceed 2 percent of the registered aggregate dollar amount of the offering and no member acts as an underwriter for the securities. Distribution managers may provide and receive compensation for a range of different services related to a public offering. Given this broad range of services, FINRA does not agree that providing an exemption from Rule 5110's provisions is appropriate based on the compensation for distribution manager-related services being less than the suggested threshold.

Davis Polk requested that an express exemption from Rule 5110's filing requirement be added for offerings of convertible debt of an issuer that has outstanding investment grade rated debt of the same class as that being offered if there is a bona fide public market in the common stock underlying the debt (i.e., the debt meets the exemption in proposed Rule 5110(h)(1)(B) and the underlying common stock generally meets the exemption in proposed Rule 5110(h)(1)(A)). FINRA has not received requests for an exemption for this type of convertible debt and, as such, the potential consequences of an express exemption in the current market environment are unclear. Exemptive relief from the filing requirement for this type of convertible debt may be available on a case-by-case basis as necessary and appropriate. To the extent that FINRA begins receiving numerous such requests, FINRA will evaluate whether an express exemption is warranted.

Davis Polk suggested that filing has not been previously required for shelf offerings registered for the benefit of selling shareholders that are intended to be sold in ordinary market transactions by members acting as agents (commonly called "dribble out offerings") and requested that an express exemption from the filing requirement be added to Rule 5110. Davis Polk also suggested an express exemption from the filing requirement for block trades in light of the highly competitive nature of negotiations between issuers and underwriters in connection with these offerings. Dribble out offerings and block trades are typically handled through shelf takedown offerings. As previously discussed, the proposed rule change would modify the requirements for shelf offerings to no longer require the filing of each takedown offering.

ABA stated that the proposed exemption in the Notice 17-15 Proposal from the filing requirement for follow-on offerings by qualifying tender offer funds should be extended to also cover IPOs by these entities. ABA requested that, if continued filing of IPOs by these issuers is required, Rule 5110 should be amended to provide that the underwriting terms and arrangements for these offerings, while subject to the filing requirements of Rule 5110, will be reviewed for compliance with the requirements of Rule 2341. As discussed in Item II.A. supra, FINRA believes that it is appropriate to consider compensation for distribution of both IPOs and follow-on offerings of tender offer funds under the compensation limitations in Rule 2341. Accordingly, the proposed rule change would exempt both IPOs and follow-on offerings of tender offer funds from Rule 5110.[103]

As offerings of open-end funds and continuously offered interval funds and tender offer funds are exempted from Rule 5110, JLL suggested exempting offerings of continuously offered perpetual-life, publicly offered non-listed REITS ("PLRs") from the filing requirement. Open-end funds and continuously offered interval funds and tender offer funds are investment companies whose offerings can be appropriately regulated under the Investment Company Act; however, PLRs are generally exempt from the Investment Company Act. Because the protections of the Investment Company Act would not apply, the proposed rule change would not exempt PLRs from the filing requirement.

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[103] See proposed Rule 5110(h)(2)(L).

ABA suggested that the exemption from Rule 5110's filing requirement for securities offered by issuers with qualifying debt securities be expanded to include offerings by issuers that are organized limited liability companies, limited partnerships, business trusts or other legal persons.[104] The Notice 17-15 Proposal would have replaced "corporate issuer" with "corporation" in this exemption. Rather than including a lengthy list of different types of legal persons, the proposed rule change would revert to the use of "corporate issuer." This approach, which is consistent with Rule 5110 currently, covers a broad range of legal entities that have qualifying debt securities and has not been problematic in practice.

CAI supported the proposed exemption in Rule 5110(h)(2)(E) from the filing and substantive requirements of Rule 5110 for "any insurance contracts not otherwise included" as appropriately resolving members' questions about the status of insurance contracts under FINRA rules. SIFMA also supported the addition of proposed exemptions from the filing and substantive requirements of Rule 5110 for insurance contracts[105] and unit investment trust securities.[106]

ABA requested clarification as to whether the exemption from the filing and substantive provisions of Rule 5110 for securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Company Utility Holding Company Act ("PUHCA") remains tied to that Act. The Energy Policy Act of

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104 See proposed Rule 5110(h)(1)(A).

105 See proposed Rule 5110(h)(2)(E).

106 See proposed Rule 5110(h)(2)(K).

2005 repealed the PUHCA Act of 1935 and adopted the PUHCA of 2005.[107] The exemption for any securities issued pursuant to any competitively bid underwriting arrangement meeting the requirements of the PUHCA continues to be appropriate. Accordingly, consistent with the current Rule, the proposed rule change would exempt from the filing and substantive requirements of Rule 5110 securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the PUHCA.[108]

Sullivan stated that all offerings of investment grade debt, preferred stock and other fixed-income securities should be exempt from Rule 5110's filing and substantive requirements. Sullivan stated that these offerings involve the tightest underwriting spreads and are intensely negotiated by issuers and, accordingly, the protections of Rule 5110 are not necessary for these offerings. Although some offerings of investment grade debt, preferred stock and other fixed-income securities are intensely negotiated by issuers, offerings of these securities have previously involved unreasonable and unfair underwriting terms and arrangements. Because Rule 5110 prohibits unreasonable and unfair underwriting terms and arrangements, it is appropriate for the Rule's protections to continue to apply to these offerings.

Disclosure of Underwriting Compensation

The Notice 17-15 Proposal would have no longer required that the disclosure include the dollar amount ascribed to each individual item of compensation. Instead the Notice 17-15 Proposal would have permitted a member to disclose the maximum aggregate amount of all underwriting compensation, except the discount or commission

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107 See Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

108 See proposed Rule 5110(h)(2)(H).

that must be disclosed on the cover page of the prospectus. The Notice 17-15 Proposal also included a requirement to disclose specified material terms and arrangements in the prospectus, which is consistent with current practice. A description would be required for: (1) any ROFR granted to a participating member and its duration; and (2) the material terms and arrangements of the securities acquired by the participating member (e.g., exercise terms, demand rights, piggyback registration rights and lock-up periods).[109]

Commenters expressed differing viewpoints on the proposed prospectus disclosure requirement changes in the Notice 17-15 Proposal. ADISA supported changing the disclosure requirements to require disclosure only of the aggregate amount of all compensation, other than discounts and commissions, in the prospectus. On the other hand, NASAA supported retaining the requirement in Rule 5110 for itemized underwriter compensation disclosure in the prospectus and did not support the proposed disclosure requirement changes in the Notice 17-15 Proposal. NASAA stated that itemized compensation: (1) allows investors to understand how money is being disbursed to underwriters; (2) provides investors with a better understanding of incentives underlying an underwritten public offering; and (3) provides investors additional liability protections for any misstatements in the disclosure. Davis Polk requested clarification as to the specific disclosure requirements for securities acquired by participating members that are deemed underwriting compensation.

As noted in Item II.A. above, recognizing commenters' conflicting views, the proposed rule change would retain the current requirements for itemized disclosure of

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[109] See proposed Supplementary Material .05 to Rule 5110.

underwriting compensation.[110] The proposed rule change would make explicit the existing practice of disclosing specified material terms and arrangements related to underwriting compensation, such as exercise terms, in the prospectus.[111]

Underwriting Compensation

While removal of Rule 5110's references to "items of value" was supported,[112] commenters requested several clarifications or changes to the proposed definition of underwriting compensation. Two commenters suggested that the reference to compensation received from "any source" in the proposed underwriting compensation definition was overly broad and should be deleted to instead focus on benefits received from or at the direction of the issuer.[113] Alternatively, if the phrase "any source" is not deleted, the commenters suggested that the definition should, at a minimum, be more narrowly tailored to address any specific concerns. Underwriting compensation typically is paid by the issuer, but FINRA has charged violations of its Corporate Financing Rules in connection with quid pro quo arrangements between underwriters and institutional investors for the allocation of hot issues that would make narrowing the source of compensation to issuers in all cases problematic.[114]

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110 See proposed Rule 5110(b)(1) and Supplementary Material .05 to Rule 5110. See also proposed Rule 5110(e)(1)(B) requiring disclosure of lock-ups.

111 See proposed Supplementary Material .05 to Rule 5110.

112 See SIFMA.

113 See Davis Polk and SIFMA.

114 See News Release, NASD, NASD Regulation Charges Credit Suisse First Boston with Siphoning Tens of Millions of Dollars of Customers' Profits in Exchange for "Hot" IPO Shares (January 22, 2002), http://www.finra.org/newsroom/2002/nasd-regulation-charges-credit-suisse-first-boston-siphoning-tens-millions-dollars. See also News Release, SEC, SEC Charges CSFB with Abusive IPO Allocation

Two commenters suggested revising the proposed underwriting compensation definition to provide that only payments made or securities received during the "review period" would be included in underwriting compensation.[115] In its reviews, FINRA typically only considers payments and benefits received during the applicable review period in evaluating underwriting compensation. However, if there is an arrangement, in fact, to pay compensation related to the underwriting outside the review period, the payment must be included under Rule 5110. Accordingly, the proposed rule change does not limit the proposed underwriting compensation definition to payments and benefits received during the review period.

SIFMA suggested deleting the last sentence of the proposed underwriting compensation definition, as that sentence would imply that finder's fees and underwriter's counsel fees are counted as compensation even if not reimbursed to the participating member. The approach in the proposed underwriting compensation definition is consistent with the treatment in the current Rule, which includes both finder's fees and underwriter's counsel fees as items of value.[116] The proposed rule change provides among the examples of payments that would be underwriting compensation: (1) fees and expenses of participating members' counsel paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement

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Practices CSFB Will Pay $100 Million to Settle SEC and NASD Actions; Millions in IPO Profits Extracted from Customers in Exchange for Allocations in "Hot" Deals (January 22. 2002), https://www.sec.gov/news/headlines/csfbipo.htm.

115 See Davis Polk and Rothwell.

116 See current Rule 5110(c)(3)(A)(iii)-(iv).

of "blue sky" fees); and (2) finder's fees paid or reimbursed to, or paid on behalf of, the participating members.[117]

Davis Polk suggested revising the proposed underwriting compensation definition to exclude securities of foreign (non-U.S.) issuers acquired by participating members in the issuer's domestic market if such market meets certain volume and float requirements. In determining whether the securities are underwriting compensation, Davis Polk suggested that considering whether the securities are traded on a "designated offshore securities market" (as defined in Rule 902(b) of SEC Regulation S) is overly restrictive and not meaningful; rather, the focus should be on whether the securities are freely trading so that the price paid is the fair market price. For this reason, Davis Polk also suggested that proposed Rule 5110(a)(4)(B)(iv) be modified so that participating members need not provide information regarding issuer securities they acquire during the review period in the issuer's domestic market.

The approach in the proposed rule change to provide that "listed securities" purchased in public market transactions would not be considered underwriting compensation is consistent with the treatment of these securities in the current Rule.[118] This treatment has not been historically problematic, with any issues related to securities of foreign (non-U.S.) issuers acquired by participating members in the issuer's domestic

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117 See proposed Supplementary Material .01(a)(3) and (4).

118 See proposed Supplementary Material .01(b)(11) to Rule 5110. Substantively consistent with the current Rule, proposed Supplementary Material .01(c)(1) to Rule 5110 would define listed securities to mean "securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S."

market arising infrequently. However, the integrity of foreign markets may vary significantly and information regarding shares obtained in those markets may be important to FINRA's review. While the proposed rule change does not propose to alter the treatment for these securities, exemptive relief may be available on a case-by-case basis as necessary and appropriate.

Davis Polk requested clarification as to whether fees and other compensation paid to foreign broker-dealers in connection with the foreign (non-U.S.) distribution of the offering should be deemed underwriting compensation. Rule 5110 does not apply to fees and other compensation paid to underwriters for securities distributions made exclusively in foreign markets. Notwithstanding that some shares may be sold in foreign markets global offerings typically register shares in the U.S. to accommodate the potential for flow back in the U.S. At the time of FINRA's review, the exact amount of shares that will be sold in the U.S. is not available. Therefore, FINRA's initial review is based on the entire amount registered.

Two commenters suggested that the lack of an express public standard for determining when the aggregate amount of proposed underwriting compensation is unfair and unreasonable under Rule 5110 has caused confusion on the part of issuers, underwriters and counsel.[119] 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, as well as all other relevant facts and circumstances: (1) the anticipated maximum amount of offering

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[119] See EGS and Rothwell.

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.[120]

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.

Examples of Payments or Benefits that Are or Are Not Considered Underwriting Compensation

Commenters requested clarification or expansion of the proposed non-exhaustive lists of examples of payments or benefits that would be and would not be considered underwriting compensation. SIFMA suggested that the prefatory language to proposed Supplementary Material .01(a) should state "[t]he following are examples of payments or benefits that are considered underwriting compensation 'if received during the review period for underwriting, allocation, distribution, advisory or other investment banking services provided in connection with the public offering.'" The proposed rule change does not include a reference to the review period in the prefatory language. As discussed above, if there is an arrangement, in fact, to provide payments or benefits for

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[120] These factors are set forth in current Rule 5110(c)(2)(D). Because this guidance is more appropriate for a Regulatory Notice than rule text, the proposed rule change would eliminate the factors in the current Rule. However, FINRA will consider whether additional discussion of this topic in a Regulatory Notice or frequently asked questions would be helpful.

underwriting services outside the review period, the payments or benefits must be included under Rule 5110. Moreover, because the proposed definition of underwriting compensation already refers to underwriting, allocation, distribution, advisory or other investment banking services provided in connection with a public offering, it is unclear how adding the language to the lists of examples would be helpful.

Two commenters suggested that the items in proposed Supplementary Material .01(a)(3) and (4) to Rule 5110 be revised to clarify that such items (i.e., finder's fees and counsel fees) are counted as underwriting compensation solely to the extent they are reimbursed to, or paid on behalf of, the participating members.[121] This is consistent with the approach in proposed Supplementary Material .01(a)(2) to Rule 5110 for other fees and expenses, including, but not limited to, road show fees and expenses and due diligence expenses. Accordingly, FINRA made the suggested change.

SIFMA suggested that proposed Supplementary Material .01(a)(7) to Rule 5110 be revised to provide that common stock and other equity securities would not be considered underwriting compensation if purchased or acquired in a transaction that complies with proposed Rule 5110(d) or is otherwise excluded as underwriting compensation pursuant to other provisions of the proposed Rule (including Supplementary Material .01(b) to Rule 5110). The list of examples of underwriting compensation in proposed Supplementary Material .01(a) to Rule 5110 is intended to be read in combination with the venture capital exceptions and list of examples of what would not be considered underwriting compensation. The proposed rule change does not incorporate the suggested change because it is unclear how adding cross-references to

121 See ABA and SIFMA.

Supplementary Material .01(a)(7) to Rule 5110 would be beneficial. Rather, adding the cross-reference to one example of underwriting compensation as suggested would seem to add confusion, not clarity, to the Rule's requirements.

SIFMA suggested that proposed Supplementary Material .01(a)(9) to Rule 5110 be revised to eliminate the one percent valuation assigned to ROFRs. SIFMA suggested that ROFRs be deemed underwriting compensation but be assigned zero compensation value (unless the agreement in which the ROFR is granted contains a dollar amount contractually agreed to by the parties to waive the ROFR, in which case that amount should be included). ROFRs have historically been assigned a one percent valuation for purposes of Rule 5110. FINRA continues to believe that ROFRs are a valuable benefit that traditionally have been used in combination with other forms of compensation to reward underwriters and that this historical approach to valuing ROFRs is reasonable.

SIFMA acknowledged that proposed Supplementary Material .01(a)(13) to Rule 5110 – which provides that any compensation paid to any participating member in connection with a prior proposed public offering that was not completed is considered underwriting compensation, if the member participated in the revised public offering – is consistent with the current Rule. However, SIFMA questioned the rationale for the treatment of this compensation if it was received in accordance with proposed Rule 5110(g)(5) – which sets forth the requirements for termination fees. SIFMA suggested that proposed Supplementary Material .01(a)(13) to Rule 5110 should make it clear that the prior compensation would be treated as underwriting compensation only if it is received within the review period for the new public offering.

Rule 5110's termination provisions were revised in 2014 to provide members with greater flexibility in negotiating the terms of their agreements for terminated offerings, while also providing protection for issuers if a member fails materially to perform the underwriting services contemplated in the written agreement.[122] The proposed Supplementary Material, which is consistent with the current Rule, continues to fulfill this purpose. Furthermore, the compensation received in a prior terminated offering would be considered underwriting compensation under Rule 5110 only if the member participates in the revised public offering.

With respect to proposed Supplementary Material .01(a)(14) to Rule 5110, SIFMA stated that gifts and business entertainment provided in compliance with the limits set forth in proposed Rule 5110(f)(2)(A) and (B) (which allow for nominal gifts and occasional meals, sporting events or comparable entertainment) should not be counted as underwriting compensation as there is no rationale and investor protection goal served by the imposition of this requirement. Non-cash compensation, including gifts and business entertainment, in connection with a public offering may be reasonably considered underwriting compensation. To the extent that any gifts and business entertainment are provided in compliance with the limits set forth in proposed Rule 5110(f)(2)(A) and (B), the amount of underwriting compensation attributable to the gifts and business entertainment should not be significant in practice. With that said, FINRA is currently reviewing all of its non-cash compensation provisions in the context of a separate retrospective rule review.[123]

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122 See Securities Exchange Act Release No. 72114 (May 7, 2014), 79 FR 27355 (May 13, 2014) (Order Approving File No. SR-FINRA-2014-004).

123 See Regulatory Notice 16-29 (August 2016).

Davis Polk noted that proposed Supplementary Material .01(b)(1) provides that fees of "independent financial advisers" would not be underwriting compensation but questioned the treatment of fees paid to members for acting solely as "financial advisers." The proposed rule change would define an independent financial adviser consistent with the current Rule.[124] Application of the Rule to financial advisers was addressed when the defined term independent financial adviser was added to Rule 5110 in 2014.[125] The application of the Rule to fees paid to financial advisers and the carve-out for fees of independent financial advisers, as that term is defined, continues to be appropriate.

SIFMA suggested that proposed Supplementary Material .01(b)(2) to Rule 5110 should exclude from underwriting compensation "cash compensation received for providing services in a private placement," rather than being limited to acting as a placement agent. SIFMA stated that limiting the provision to receipt of cash compensation solely for acting in a placement agent capacity is unnecessarily narrow and should be removed. Rule 5110 currently provides that cash compensation received for acting only as a private placement agent would not be an item of value. Member's roles in acting as a placement agent and in providing services in a private placement similarly facilitate offerings. Upon further review, FINRA agrees that this carve-out can be expanded to include the provision of other services by a member for a private placement without the risk of harm to investors. Accordingly, the proposed rule change would

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124 See current Rule 5110(a)(5)(B) and proposed Rule 5110(j)(9).

125 See Securities Exchange Act Release No. 71372 (January 23, 2014), 79 FR 4793 (January 29, 2014) (Notice of Filing of File No. SR-FINRA-2014-003). See also Letter from Kathryn M. Moore, Associate General Counsel, FINRA, to Kevin O'Neill, Deputy Secretary, SEC, (regarding File No. SR-FINRA-2014-003), dated April 16, 2014.

expand the scope of proposed Supplementary Material .01(b)(2) to Rule 5110 to include cash compensation for providing services for a private placement.

Two commenters suggested that proposed Supplementary Material .01(b)(11) to Rule 5110 should be modified to remove the reference to “listed” securities (i.e., all securities purchased in public market transactions should be excluded from underwriting compensation, regardless of whether they are listed).[126] The proposed approach is consistent with the treatment in Rule 5110 currently, which provides that listed securities acquired in public market transactions would not be an item of value.[127] The defined term “listed securities” in Supplementary Material .01(c)(1) of Rule 5110 provides greater clarity on the scope of covered securities than the commenters’ suggestion.

Three commenters suggested amending proposed Supplementary Material .01(b)(12) to Rule 5110 to expressly provide that securities received by directors or employees under any written compensatory benefit plan would not be underwriting compensation.[128] The commenters stated that these types of plans are for the purpose of compensating directors and employees and are unrelated to underwriting compensation in connection with a public offering. FINRA would interpret the reference to a “similar plan” in proposed Supplementary Material .01(b)(12) to Rule 5110 to include a written compensatory benefit plan for directors and employees that provides comparable grants of securities to similarly situated persons (e.g., a written compensatory benefit plan that provides comparable grants of securities to all qualifying employees) and accordingly

126 See ABA and SIFMA.

127 See current Rule 5110(c)(3)(B)(iii).

128 See ABA, Davis Polk and Rothwell.

does not propose to change the Rule text. A "similar plan" would not include a compensatory benefit plan that was developed or structured to circumvent the requirements of Rule 5110.

SIFMA suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include any cash compensation, securities or other benefit received by a person who was not, at the time of the acquisition of the compensation, an associated person, immediate family or affiliate of a participating FINRA member. Because persons have previously transferred from issuers to members around the time of securities acquisitions, the proposed rule change would not provide an express carve-out provision as suggested. However, exemptive relief may be available for bona fide transfers on a case-by-case basis as necessary and appropriate.

SIFMA suggested amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include any cash compensation, securities or other benefit received by an associated person, immediate family or affiliate of a participating member if the member or its parent or other affiliate is issuing its own securities in the public offering. Because a broad carve-out could be used to circumvent the requirements of Rule 5110, the proposed rule change would not provide an express provision as suggested. Exemptive relief may be available on a case-by-case basis as necessary and appropriate where a participating member or its parent or other affiliate is issuing its own securities in the public offering.

Several commenters suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization. Specifically, SIFMA suggested amending proposed Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include acquisitions of securities before or after the required filing date by participating members pursuant to a U.S. or non-U.S. governmental or court-approved proceeding or plan of reorganization in which new securities are issued to or are available for purchase by existing securities holders (e.g., a bankruptcy or tax court proceeding) where such participating members receive or purchase such securities on the same terms as other similarly-situated security holders. ABA supported amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities acquired by a participating member in connection with a court-approved bankruptcy process. In addition, Davis Polk supported amending Supplementary Material .01(b) to Rule 5110 to expressly provide that underwriting compensation would not include securities issued pursuant to court order.

Because these securities acquisitions would be overseen by the government or court, the risk of intentional circumvention of Rule 5110 or investor harm is minimized. Accordingly, the proposed rule change would provide that underwriting compensation would not include securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding).[129]

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[129] See proposed Supplementary Material .01(b)(22) to Rule 5110.

Venture Capital Exceptions from Underwriting Compensation

SIFMA requested that FINRA state affirmatively that Rule 5110's venture capital exceptions are non-exclusive safe harbors and that other securities acquisitions that do not meet one of the express safe harbors (or fall within other exceptions provided elsewhere in Rule 5110) would also be excluded from characterization as underwriting compensation (and the accompanying lock-up restrictions) if the acquisition of the securities by the participating member is not compensation for providing underwriting, allocation, distribution, advisory or other investment banking services in connection with the public offering. FINRA proposes to retain an objective standard for distinguishing securities acquired in bona fide venture capital transactions from those acquired as underwriting compensation. While retaining this objective standard, the proposed rule change provides additional flexibility for members via the principles-based approach for significantly delayed offerings or the examples in proposed Supplementary Material .01(b) in some securities acquisitions not being underwriting compensation.

ABA generally supported the proposed changes to the venture capital exceptions but suggested that some additional changes be considered. Specifically, ABA suggested that the requirement that the participating member must acquire the issuer's securities "at the same price and with the same terms as securities purchased by all other investors" be revised such that the participating member may acquire its securities "on no better terms" than the other investors. ABA noted that members may choose to forego voting rights or other indicia of control when purchasing an issuer's securities and this detrimental variation in the purchase terms should not deny a participating member the ability to rely on the exceptions.

Introducing the concept of securities acquisitions "on no better terms" would introduce considerable uncertainty into the evaluation of whether any of the venture capital exceptions would be available. The "on no better terms" concept would require a weighing and consideration of all of the various terms of a securities acquisition, which could be time consuming for members, counsel and FINRA staff. Retaining the concept of "at the same price and with the same terms," which is in the current Rule, provides objectivity and clarity.

ABA also requested revising proposed Rule 5110(d)(1)(B) to read "investment or loan" rather than "investment and loan" to make clear that the provision does not require a participating member or its affiliate to make both an investment in and a loan to the issuer in order to rely on the exception. To clarify that both an investment in and a loan to the issuer are not required, the proposed rule change would revert to the current use of "or" in current Rule 5110(d)(5)(A)(i)c.[130]

Two commenters supported amending the timing requirement for the venture capital exceptions to allow for application to situations in which the participating member or its affiliate has made its investment in the issuer after the required filing date.[131] If not so amended, SIFMA suggested either: (1) eliminating the pre-filing timing restriction in proposed (d)(1) and (2), which address securities acquired by certain affiliates of a participating member; or (2) establishing for all of these exceptions a formal mechanism to reset the required filing date for significantly delayed offerings.

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130 See proposed Rule 5110(d)(1)(B).

131 See ABA and SIFMA.

When an offering has been significantly delayed, FINRA would consider the factors in proposed Supplementary Material .02 to Rule 5110 discussed above to analyze whether securities acquired in a transaction that occurs after the required filing date, but otherwise meets the requirements of a venture capital exception, may be excluded from underwriting compensation.

SIFMA suggested that the venture capital exceptions be amended to provide that the determination as to the availability of an exception is to be made by the participating member at the time of the acquisition of the securities and on the basis of the information then known to the participating member. Except for the principles-based approach for significantly delayed offerings, the venture capital exceptions apply to the acquisition of securities before the required filing date. Accordingly, whether an acquisition of the securities meets an exception must be determined before the required filing date.

NASAA expressed concern about removing the restriction in current Rule 5110(d)(5)(A) and (B) that the exception from underwriting compensation is available only to underwriters and their affiliates who own less than 25 percent of the issuer's total equity, as the removal of the restriction may increase the potential for conflicts of interest to arise. NASAA questioned whether the proposed changes further investor protection and whether the protections of Rule 5121 are adequate. FINRA believes, however, the proposed rule change would eliminate an unnecessary restriction in the relevant venture capital exceptions. Post-2004 regulatory changes in other areas, such as the 2009 revision of Rule 5121 regarding public offerings with a conflict of interest, have added protections to address acquisitions that create control relationships. Moreover, in FINRA's experience control transactions that result in ownership of more than 25 percent of an issuer involve significant investment risks and are not designed to be a means to obtain additional underwriting compensation.

SIFMA stated that the addition of "through a subsidiary it controls" in the venture capital exceptions in proposed Rule 5110(d)(1) and (2) is a useful clarification, but suggested that provision be modified to require that "the affiliate is 'or will be' primarily engaged in the business of making investments in or loans to other companies, 'or has been formed for the purpose of making this investment or loan by a parent that is directly or indirectly engaged in such activities.'" SIFMA suggested that this modification would address situations in which the investing entity is a newly formed vehicle and does not, outside the present investment, have a history of making such investments in other companies.

Expanding the scope of the exceptions to cover direct, indirect or newly formed entities that are in the business of making investments and loans acknowledges the different structures that may be used to participate in bona fide venture capital transactions. Expanding these exceptions to cover entities that may be formed in the future could undermine the protection that results from requiring an entity to be in the business of making such acquisitions, rather than one simply formed to participate in a compensation transaction.

SIFMA supported increasing the participating members' aggregate acquisition threshold from 20 percent to 40 percent of the total offering in the venture capital exception in proposed Rule 5110(d)(3). SIFMA suggested, however, that limiting this venture capital exception to receipt of the securities for placement agent activities is too narrow and should be removed (e.g., securities-related compensation could be offered by an issuer in return for advisory or other services provided by a participating member in connection with the private placement, rather than for services as a placement agent).

FINRA believes that the venture capital exception in proposed Rule 5110(d)(3) can be expanded to include the provision of other services for a private placement without the risk of harm to investors. Accordingly, the proposed rule change would expand the scope of proposed Rule 5110(d)(3) to include providing services for a private placement (rather than just acting as a placement agent). Proposed Rule 5110(d)(3) would also be clarified to refer to 51 percent of the "total number of securities sold in the private placement." The current rule text states "at least 51 percent of the 'total offering' (comprised of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member)."

SIFMA also suggested adding another venture capital exception from underwriting compensation for securities acquired before or after the required filing date by a participating member in connection with a loan or a private placement in which securities (at the same price and with the same terms) were also acquired by certain types of special investors, including: (1) registered investment companies; (2) a fund or insurance company that meets the qualifications in proposed paragraph (d)(1), (2) or (3); (3) a publicly traded company that is listed on a national securities exchange or a non-U.S. issuer that meets the quantitative designation criteria for listing on a national securities exchange; (4) a benefit plan qualified under Section 401(a) of the Internal Revenue Code (provided that such plan is not sponsored by the participating member); (5) a state or municipality, or a state or municipal government benefits plan that is subject to state and/or municipal registration; (6) a sovereign wealth fund or similar investment vehicle; (7) a bank as defined in Section 3(a)(6) of the Exchange Act; or (8) an organization described in Rule 15a-6(a)(4)(ii), provided no participating member manages such entity's investments or otherwise controls of directs the management or policies of such entity and such entity or entities acquire in the aggregate at least 10 percent of the total offering.

Providing the suggested venture capital exception could result in a significant expansion of the historical scope of Rule 5110's venture capital exceptions, as the identified special investors represent much of the traditional pool of pre-IPO investors. Providing such a broad exception, without requirements comparable to those imposed by the other exceptions, could result in most securities acquisitions by participating members before the required filing date being excepted from underwriting compensation. However, a participating member may make a co-investment in an issuer in circumstances that do not fit the conditions for the current venture capital exceptions. Where a highly regulated entity with significant disclosure requirements and independent directors who monitor investments is also making a significant co-investment in the issuer and is receiving securities at the same price and on the same terms as the participating member, the securities acquired by the participating member in a private placement are less likely to be underwriting compensation.

To address such co-investments, the proposed rule change would adopt a new venture capital exception from underwriting compensation for securities acquired in a private placement before the required filing date of the public offering by a participating member if at least 15 percent of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that are open-end investment companies not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering. These conditions lessen the risk that the co-investment would be made for the purpose of the participating member avoiding the requirements of Rule 5110.

Treatment of Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

Commenters requested clarifications and modifications to the treatment of non-convertible or non-exchangeable debt securities and derivatives. Rothwell stated that non-convertible or non-exchangeable debt securities should not be underwriting compensation, regardless of whether the securities were acquired in a transaction related to the offering, as they are unlikely to be used as a payment for investment banking services. If these debt securities continue to be treated as underwriting compensation, Rothwell recommended adopting a narrower exception from underwriting compensation for these debt securities issued at par (if the purchaser is the sole purchaser) or purchased at least at the same price as other purchasers at or about the same time for the same issue of debt. Rothwell stated there would be no investor protection benefit to including such securities in underwriting compensation. Rothwell suggested that this valuation method would provide an objective methodology that is appropriate to these debt securities and is consistent with investor protection.

SIFMA stated that non-convertible or non-exchangeable debt securities and derivative instruments that are acquired or entered into at a fair price in a transaction related to a public offering should not be considered underwriting compensation. However, SIFMA suggested that such arrangements should continue to be disclosed in the prospectus because they are entered into in transactions related to the public offering.

As a secondary option, SIFMA suggested that proposed Supplementary Material .06 to Rule 5110 be modified to provide that: (1) "non-convertible or non-exchangeable debt securities and derivative instruments acquired 'from or entered into with the issuer' in a transaction related to the public offering and at a fair price will be considered underwriting compensation but will have no compensation value"; and (2) any securities or other payment received by a participating member during the review period in connection with the settlement or termination of a derivative instrument that was entered into at a fair price in a transaction related to the public offering will, like the derivative instrument itself, have no compensation value. SIFMA further commented that if the suggested change is not made, proposed Rule 5110(g)(8), which prohibits certain terms in connection with "the receipt of underwriting compensation consisting of any option, warrant or convertible security," should be modified to exclude fair price derivatives.

Because "related to the offering" is not defined, Davis Polk suggested that the test of whether the non-convertible or non-exchangeable debt and derivative instruments were acquired at a fair price provides a more meaningful standard. Rothwell stated that the terms "related to the public offering" and "unrelated to the public offering" as used in the Rule are confusing and that it would be more appropriate to treat securities as underwriting compensation if not acquired at a fair price or to apply the standards in the definition of "underwriting compensation."

Rule 5110 distinguishes between whether the non-convertible or non-exchangeable debt securities and derivative instruments were acquired in a transaction related or unrelated to a public offering. The proposed rule change would clarify that non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction unrelated to a public offering would not be underwriting compensation. Consistent with the current Rule, these debt securities and derivative instruments would not be subject to Rule 5110 (i.e., a description of the debt securities and derivative instruments need not be filed with FINRA, there are no valuation-related requirements and the lock-up restriction does not apply).

In contrast, non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to a public offering would be underwriting compensation and a description of these debt securities or derivative instruments must be filed with FINRA. The proposed rule change would clarify that these debt securities and derivative instruments acquired at a fair price would be considered underwriting compensation but would have no compensation value, while these debt securities and derivative instruments acquired not at a fair price would be considered underwriting compensation and subject to the normal valuation requirements of Rule 5110.

SIFMA also suggested the definition of fair price be revised to clarify that securities or instruments that are intended to be compensatory in nature for acting as a private placement agent for the issuer, for providing a loan, credit facility, merger, acquisition or any other service, including underwriting services, would not be viewed as having been acquired or entered into at a fair price, otherwise the reference to "any other service" could be read broadly as to render the definition meaningless. To clarify the scope of the definition, the proposed rule change would provide that a "derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price."[132]

Lock-Up Restrictions

Commenters requested several changes to the lock-up restriction, including the length of and securities subject to the restriction. Some commenters agreed that a 180-day lock-up period would be appropriate for IPOs but recommended a shorter (e.g., 30- to 45-day) lock-up period for follow-on offerings.[133] SIFMA also suggested that the lock-up requirement not apply in connection with offerings of securities that have a bona fide public market (as that term is defined in Rule 5121).

In contrast, NASAA noted that the NASAA Promotional Shares Statement of Policy requires a lock-up period that is much longer than 180 days (i.e., that promotional shares that are not fully paid will be subject to a lock-up agreement for at least one or two years following the completion of the offering) to ensure that investors and promoters assume similar risks in the offering. Consequently, NASAA urged requiring a longer lock-up period under Rule 5110 to more closely align the interests of the underwriters with those of the investors in the offering.

The proposed rule change continues the historical approach of a 180-day lock-up period for both initial and follow-on public offerings. While the insider lock-up period could be less than 180 days in a follow-on offering, the insider lock-up period is commonly 180 days in IPOs. Keeping the same lock-up period for underwriters and the issuer's insiders provides equivalent protections for the secondary market. While the

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132 See proposed Supplementary Material .06(b) to Rule 5110.

133 See ADISA, Rothwell and SIFMA.

insider lock-period may vary among follow-on offerings, a consistent 180-day lock-up period for underwriters ensures that they do not accept less investment risk than insiders subject to a 180-day lock-up period.

ABA commended FINRA for revising the lock-up restrictions under proposed Rule 5110(e)(1) to clarify that the 180-day restricted period begins with the date of commencement of sales in the public offering and to minimize the impact of the lock-up restriction by including some important additional exemptions. NASAA supported the lock-up restriction being determined by the date of commencement of sales in the public offering (rather than from the date of effectiveness) and suggested that this change would provide increased protection for investors. However, ADISA suggested that the lock-up restriction should be determined using the date of effectiveness to provide clarity to all participants as the term "commencement of sales" can be vaguer and harder to determine rather than the definitive date of effectiveness.

Because the approach in the Notice 17-15 Proposal provides clarity in measuring the lock-up period, particularly with respect to securities sold pursuant to a registration statement or amendment thereto that does not have to be declared effective by the SEC, the proposed rule change retains the approach that the lock-up restriction is determined by the date of commencement of sales in the public offering (rather than from the date of effectiveness).

ABA stated that the lock-up restriction should apply only to equity securities received in transactions that are not registered with the SEC and that the lock-up restriction in the Notice 17-15 Proposal would potentially expand the scope of the lock-up restriction to include all public offerings. Rothwell stated that the lock-up restriction should apply only to securities deemed underwriting compensation in the case of public offerings of equity securities. Rothwell suggested revising the lock-up restriction to state that the restriction applies only in the case of a public equity offering of common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered.

The Notice 17-15 Proposal provided a broad lock-up requirement with several delineated exceptions. FINRA agrees that the scope of the lock-up requirement should be "public equity offering" as is used in the current Rule. The proposed rule change simplifies, clarifies and reduces the securities considered underwriting compensation and thus subject to the lock-up restriction. To the extent that securities are underwriting compensation and subject to lock-up restriction, exemptive relief may be available on a case-by-case basis as necessary and appropriate.

ABA requested guidance with respect to whether it is intended that the lock-up restriction would prevent participating members from selling securities acquired as underwriting compensation in the public offering itself. The proposed rule change would add an exception from the lock-up restriction for securities that were received as underwriting compensation, and are registered and sold as part of a firm commitment offering.[134] This is intended to give some flexibility to members in selling securities received as underwriting compensation, while limiting the proposed exception to firm commitment offerings where the underwriter has assumed the risk of marketing and distributing an offering that includes securities the underwriter received as underwriting

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134 See proposed Rule 5110(e)(2)(A)(viii).

compensation. In addition, firm commitment offerings are usually marketed and sold to institutional investors, who typically purchase a majority of the shares in such offerings.

SIFMA stated that the Notice 17-15 Proposal appeared to subject non-convertible or non-exchangeable debt securities and derivative instruments acquired at a fair price in a transaction related to the offering and non-listed securities of an issuer acquired in a public market transaction to Rule 5110's lock-up restriction, unless the security is of an issuer that meets the registration requirements of current Forms S-3, F-3, F-10 (for brevity, referred to herein as "current eligible issuers"). SIFMA supported the exception for current eligible issuers, but stated that the lock-up restriction should apply only to public offerings of equity and equity-linked securities, should cover only equity and equity-linked securities received as underwriting compensation by participating members in offerings not registered under the Securities Act and should provide an express exception for fair price derivatives. Moreover, SIFMA suggested that the proposed exception for current eligible issuers should be clarified to expressly provide that the exclusion also applies to derivative instruments entered into with such issuers.

Davis Polk stated that application of the lock-up restriction to non-convertible or non-exchangeable debt securities and derivative instruments is not justified and may interfere with some derivative transactions. Rothwell suggested that non-convertible or non-exchangeable debt securities deemed to be underwriting compensation should be excluded from the lock-up restriction as there is no investor protection benefit to be received. Rothwell stated that these securities that are included in the calculation of underwriting compensation: (1) are likely a different issue or series than those sold to the public and will not have a public market; and (2) even if the securities are from the same issue, the public secondary market trading price of such debt securities is primarily determined by fluctuating interest rates rather than the types of market forces that affect the equity markets.

The proposed rule change would provide clarity about the treatment of non-convertible or non-exchangeable debt securities and derivative instruments acquired in transactions related to a public offering. The proposed rule change would retain the current approach for non-convertible or non-exchangeable debt securities acquired in a transaction related to the public offering and would provide an express exception from the lock-up restriction for clarity (i.e., the exception would provide that the lock-up restriction does not apply).[135]

However, derivative instruments are currently subject to Rule 5110's lock-up restriction. FINRA recognizes that members may acquire derivative instruments in connection with a hedging transaction related to the public offering and that, given the nature of these hedging transactions, the lock-up restriction should not apply. Accordingly, the proposed rule change would provide that the lock-up restriction does not apply to derivative instruments acquired in connection with a hedging transaction related to the public offering and at a fair price.[136] Derivative instruments acquired in transactions related to the public offering that do not meet the requirements of the exception would be subject to the lock-up restriction.

SIFMA suggested expressly excluding from the lock-up restriction any securities received in connection with the settlement or termination of a derivative instrument

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135 See proposed Rule 5110(e)(2)(A)(iv).

136 See proposed Rule 5110(e)(2)(A)(v).

received outside the review period or during the review period in a transaction unrelated to the public offering, such as by revising proposed Supplementary Material .01(b)(14) to Rule 5110 to read "securities acquired as the result of a conversion 'or exchange' of securities originally acquired prior to the review period and securities acquired at termination or in settlement of a derivative instrument entered into prior to the review period or during the review period in a transaction unrelated to the public offering." The lock-up restriction would not apply to securities that were acquired in a transaction unrelated to the public offering. However, because an "exchange" could relate to a wholly different transaction, the suggested revision to proposed Supplementary Material may be overly broad.

SIFMA suggested that the one percent threshold in proposed Rule 5110(e)(2)(A)(ii) – which provides that the lock-up restrictions will not apply if the aggregate amount of securities of the issuer beneficially owned by a participating member does not exceed one percent of the securities being offered – should be tied to the amount of securities received as underwriting compensation during the review period rather than more broadly to all securities held by the participating member. Accordingly, SIFMA suggested that the lock-up restriction should not apply to securities received during the review period as underwriting compensation if the amount of such securities does not exceed one percent of the securities being offered in the public offering. FINRA believes that the aggregate amount of securities beneficially owned by a participating member is a better measure of the potential impact of sales by the participating member into the secondary market.

SIFMA suggested that the exception in proposed Rule 5110(e)(2)(A)(vii) should be modified to allow for the sale or other disposition of the securities by registered investment advisers, even if such advisers are affiliated with a participating FINRA member. To accomplish this change, SIFMA suggested revising proposed Rule 5110(e)(2)(A)(vii) to state "the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that (a) no participating member '(other than a participating member that is registered as an investment adviser under the U.S. Investment Advisers Act of 1940 and is acting in accordance with its responsibilities thereunder)' manages or otherwise directs investments by the fund, and (b) participating members in the aggregate do not own more than 10 percent of the equity of the fund." SIFMA stated that participating members registered as investment advisers are separately regulated and have a fiduciary duty to act in the best interests of their clients, and the lock-up restriction may interfere with that regulatory responsibility. FINRA believes that this lock-up exception continues to be appropriate to securities received as underwriting compensation by a fund controlled by a participating member.

Defined Terms

The Notice 17-15 Proposal definition of "public offering" was based on the definition in Rule 5121, but included the delineated carve-outs in the Rule 5121 definition (which relate to certain types of securities offerings that are commonly understood not to constitute offerings to the public) separately in the list of securities offerings exempted from Rule 5110's filing and substantive requirements. The practical effect of this approach was that the carve-outs in Rule 5121 (e.g., securities exempt from registration under Securities Act Rule 144A or Regulation S) would not be subject to the filing or substantive provisions of Rule 5110.

Two commenters stated that the definition of public offering proposed in Notice 17-15 eliminated the carve-outs currently in the Rule 5121 definition of public offering, thus substantially broadening the definition.[137] The commenters requested a definition of public offering be adopted that retains the carve-outs with the definition, as such offerings would already be exempt from the Rule's coverage by virtue of the definition of public offering itself. Because the approach in the Notice 17-15 Proposal raised questions regarding the intended scope of the public offering definition, the proposed rule change incorporates the public offering definition from Rule 5121, accompanied by the delineated carve-outs, and correspondingly deletes those carve-outs from the proposed list of exemptions from the filing and substantive provisions of Rule 5110.[138]

ABA recommended revising the public offering definition to state "any primary or secondary distribution of securities 'made in whole or in part in the United States' 'to the public.'" ABA suggested that this approach would avoid circularity and more accurately reflect the types of offerings intended to be covered by the Rule. To clarify the jurisdictional scope, the proposed rule change would include "in whole or in part in the United States" in the public offering definition. However, because the addition of "to the public" may raise new questions on the scope of covered offerings, the proposed definition does not include that language.

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137 See ABA and SIFMA.

138 See proposed Rule 5110(j)(18).

SIFMA suggested that because the defined term “experienced issuer” differs from the terminology used by the SEC for purposes of Form S-3, the term is likely to lead to confusion. Beyond the name, commenters suggested modifying the definition substantively. Specifically, SIFMA suggested that the definition mean: “an issuer that (i) meets the registrant requirements specified in paragraph I.A of SEC Form S-3, except that for purposes of paragraph I.A.3 thereof, the reference to twelve calendar months shall be deemed to refer instead to 36 calendar months; and (ii) has an aggregate market value of outstanding voting and non-voting common equity held by non-affiliates (as calculated pursuant to General Instruction I.B.1 of Form S-3) of (a) at least U.S. $150 million or (b) at least U.S. $100 million and the issuer has had an annual trading volume of its common equity of at least three million shares (or share equivalent).” Sullivan suggested that, at a minimum, the experienced issuer definition should be revised to conform to existing Forms S-3 and F-3 because requiring an additional 24 months of reporting history does not enhance the ability of these issuers to fend for themselves.

ABA appreciated FINRA’s attempt to streamline Rule 5110 by using the defined term experienced issuer but suggested that the criteria is outdated and the exemption should be available to any issuer who is eligible to file a registration statement under the SEC’s current requirements for Forms S-3, F-3 and F-10. If limiting the exemption beyond the current requirements for Forms S-3, F-3 and F-10 is necessary for the protection of investors, ABA requested that FINRA consider revising the definition to also cover issuers with a 12 month reporting history if they have: (1) a public float of at least $75 million; and (2) average daily trading volume (as defined in SEC Regulation M) in their common equity securities of at least $1 million and also requested exempting issuers that meet these criteria that are filing on SEC Form N-2.

Rather than referring to the pre-1992 standards for Form S-3 and F-3 and standards approved in 1991 for Form F-10, the proposed definition of experienced issuer codifies those standards currently in Rule 5110 to simplify the analysis for the benefit of members. The continued application of the Rule to these issuers continues to be justified.[139] The proposed rule change intentionally uses language different from that used in other requirements (e.g., Form S-3's use of "seasoned issuer") to avoid confusion and make clear that the defined term covers a different set of issuers.

Two commenters stated that retaining the current definition of "institutional investor" is problematic and difficult to use, thereby rendering the venture capital exceptions in proposed Rule 5110(d)(2) and (3) largely unworkable.[140] SIFMA stated that, given the expansive definition of "participating member," it is difficult to ascertain whether an entity qualifies as an institutional investor and that the focus of the definition should instead be on whether a participating member manages the investor's investments or otherwise controls or directs the investment decisions of the investor.

SIFMA suggested defining the term "institutional investor" to mean a "person that has an aggregate of at least U.S. $50 million invested in securities in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members manage the institutional investor's investments or otherwise control or direct the investment decisions of such investor." Alternatively, if

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139 See supra discussion of previous problems associated with shelf offerings in Item II.A.

140 See Davis Polk and SIFMA.

the equity interest element of the definition is not deleted, SIFMA proposed that the: (1) reference to "equity interest" be changed to "beneficial ownership" as defined in Rule 5121; (2) thresholds for both public and non-public entities be raised to 15 percent and the reference to "entity" be changed to "investor" (due to the incorporation by reference of the specific definition of "entity" in Rule 5121 which does not fit well in this specific context in Rule 5110); and (3) calculation of the beneficial ownership threshold be limited to ownership by the participating FINRA member and its affiliates (i.e., the calculation should not include associated persons that are not otherwise "affiliates" of the member or immediate family of such persons).

Revising the institutional investor definition as suggested to focus on controlling or directing investment decisions would insert uncertainty and subjectivity into the definition. The proposed rule change retains this definition because the current definition is more objective. Moreover, because Rule 5110's venture capital exceptions are relied upon by members, FINRA does not agree that the institutional investor definition makes the venture capital exceptions unworkable.

Two commenters suggested that the Notice 17-15 Proposal's addition of "other than the issuer" at the end of the definition of "participating member" does not make it clear that the issuer is exempted from all categories of participating member.[141] To make clear that the definition does not include the issuer, the proposed rule change would define participating member to mean "any FINRA member that is participating in a

141 See ABA and Rothwell.

public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer."[142]

Three commenters stated that the proposed carve-out of the "issuer" from the definition of "participating member" is useful and would help with inadvertent overlap between the two definitions.[143] These commenters suggested that a comparable carve-out to include participating members be included in the definition of "issuer." The proposed rule change does not incorporate the suggested change to the definition of "issuer" because a participating member could also be the issuer of the securities.

SIFMA stated that the proposed definition of "issuer" referencing an "entity" offering its securities to the public may be confusing given that the defined term "entity" in Rule 5121 excludes certain types of issuers such as DPPs and REITs. To address this issue, SIFMA suggested that "issuer" be defined to mean the "registrant or other person offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant, such other person or selling security holder (other than an affiliate that is a participating member), and the officers or general partners, and directors thereof." To clarify the scope of covered persons, the proposed rule change would revise the issuer definition to refer to the "registrant or other person" (rather than "entity").[144]

ABA stated that while proposed Rule 5110(j)(2) would define the term "bank" for purposes of the Rule's venture capital exceptions, the term "bank" is not defined for

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142 See proposed Rule 5110(j)(15).

143 See ABA, Rothwell and SIFMA.

144 See proposed Rule 5110(j)(12).

purposes of the exemption for qualifying bank securities under proposed Rule 5110(h)(1). As the purpose of the proposed Rule 5110(h)(1) exemption is to exempt offerings by qualifying issuers, ABA stated that the exemption should include non-U.S. bank issuers and should not be limited to banks as defined in Exchange Act Section 3(a)(6), which definition is largely limited to U.S. domiciled banks and U.S.-based branches of non-U.S. banks.

The proposed rule change would harmonize the definition of bank in the proposed venture capital exceptions and the Rule 5110(h)(1) exemption. Specifically, the proposed rule change would define bank for purposes of Rule 5110 as "a bank as defined in Exchange Act Section 3(a)(6) or is a foreign bank that has been granted an exemption under this Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates."[145] This harmonized approach combines the definition of bank currently in Rule 5110, with the scope of banking entities currently covered by the venture capital exceptions.

ABA supported clarifying and codifying the relevant "review period" through a defined term but requested additional guidance regarding when the review period would end for offerings with an indeterminate time period such as at-the-market offerings. An at-the-market offering would be a takedown offering and the corresponding review period is set forth in proposed Rule 5110(j)(20)(C). Additional guidance regarding other offerings with indeterminate time periods may be provided as necessary or appropriate.

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145 See proposed Rule 5110(j)(2). Because of this expanded definition, the proposed rule change would delete as unnecessarily duplicative the conditions in the venture capital exceptions.

ABA questioned why the review period in proposed Rule 5110(j)(20)(C) would be limited to firm commitment or best efforts takedowns or any other continuous offering "on behalf of security holders" and requested that the definition be revised to include the issuer. ABA suggested that as proposed "on behalf of security holders" appears to qualify "firm commitment," "best efforts" and "other continuous offering" for the purpose of the review period definition. The reference to "on behalf of securities holders" was not intended to limit proposed Rule 5110(j)(20)(C) as suggested. To clarify the intended scope of the definition, the proposed rule change deletes the reference to "on behalf of security holders."

Davis Polk stated that because the review period is defined to include the 60-day period following the effective date of a firm commitment offering (or following the final closing for other offerings), participating members would be required to provide FINRA with information regarding any fees or other compensation received by them, their affiliates, associated persons, and immediate family of associated persons for 60 days following the offering, which represents a significant diligence burden. Providing a specific time period gives clarity to participating members. Moreover, the inclusion of a short period of time following the offering prevents circumvention of the Rule 5110 and is consistent with current rule, which has a 90-day requirement.

Davis Polk suggested that the definition of "required filing date" be modified for offerings that are dormant for a period of six months or more. Because the exceptions from underwriting compensation are unavailable for securities acquired by participating members after the first confidential submission to or public filing of the registration statement with the SEC, an issuer may not be able to accept financing from a participating member because of potentially excessive underwriting compensation. Accordingly, Davis Polk suggested either the definition of "required filing date" should be modified or the exceptions from underwriting compensation should be modified to apply to acquisitions by participating members of the issuer's securities after the required filing date. If the former, Davis Polk suggested that the definition provide that with respect to offerings that are dormant for six months or more, the review period begin upon the filing of the first amendment to the registration statement, which has been confidentially or publicly filed with the SEC, following the dormant period.

Availability of a venture capital exception is contingent upon the securities being acquired before the required filing date because after that date, in FINRA's experience, securities acquisitions are more likely to be underwriting compensation and issuers may be more dependent on a particular underwriter or underwriters to raise necessary capital. A public offering may be significantly delayed for legitimate reasons (e.g., unfavorable market conditions) and during this delay the issuer may require funding to operate its business or continue as a going concern. Furthermore, a member may make bona fide investments in or loans to the issuer during this delay to satisfy the issuer's funding needs and any securities acquired as a result of this funding may be unrelated to the anticipated public offering. The proposed rule change would provide some additional flexibility in the availability of the venture capital exceptions for securities acquired where the public offering has been significantly delayed as discussed above in a principles-based approach in proposed Supplementary Material .02 to Rule 5110.

Valuation of Securities

The Notice 17-15 Proposal removed the valuation formula for convertible securities and instead allowed for convertible securities to be valued 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. NASAA stated that the NASAA Underwriting Expenses Statement of Policy uses the same formula as current Rule 5110 for the valuation of underwriter's warrants in calculating total underwriting expenses. NASAA stated that the current valuation formula serves a useful purpose by providing an objective valuation method that provides consistency across different offerings and suggested that FINRA consider retaining the existing formula as a continued optional method of valuation. NASAA also urged FINRA to reexamine whether it is appropriate for an issuer to grant any options or warrants to underwriters as potential conflicts could impact the due diligence process.

EGS stated that Rule 5110 should continue to have a single valuation method to process filings in a consistent, predictable and efficient manner. EGS's expressed concerns with the approach in Notice 17-15 Proposal included: (1) varying methods will yield inconsistent results from dealer to dealer and deal to deal; and (2) assessment of a new valuation method during the pendency of a filing would delay resolution of that filing and divert FINRA staff's time and attention away from other filings.

Rothwell supported removal of the current Rule 5110 formula for valuing options but questioned whether, as a matter of policy, FINRA would continue to accept the warrant formula as a valuation method for securities that have an exercise or conversion price. Rothwell stated that there are situations where the warrant formula may continue to be a viable method for valuing securities.

SIFMA supported removal of the current Rule 5110 formula for valuing options, warrants and convertible securities to instead allow members to use a commercially available valuation method but requested additional guidance as to what should be filed with respect to such methodology. SIFMA stated that in addition to commercially available valuation models, the use of proprietary valuation models should be permitted if the member uses such a model in the ordinary course of its business to value securities of a similar type and files a description of the methodology with FINRA.

The Notice 17-15 Proposal requested comment on whether the proposed change to the valuation method was appropriate and whether the valuation method should be limited to one that is commercially available. Some commenters supported the proposed change, while others did not. Commenters did not provide any information regarding use of commercially available valuation methods, such as what methods are available and their anticipated benefits. The proposed rule change would retain the current Rule 5110 formula for valuing options, warrants and convertible securities because of the conflicting views on the proposed change to the valuation formula and the lack of information regarding what commercially available valuation methods may be used by members.

Two commenters stated that, consistent with the current Rule, members should be allowed to value non-convertible securities that are currently trading in the secondary market based on the difference between the market price at the time of acquisition (rather than the public offering price) and the acquisition cost.[146] The proposed rule change

[146] See Rothwell and SIFMA.

would retain the current Rule 5110 formula and, consequently, would allow members to value non-convertible securities that are currently trading in the secondary market based on the difference between the market price at the time of acquisition (rather than the public offering price) and the acquisition cost.

Rothwell stated that the valuation of unit securities is not addressed in either the current Rule 5110 or the proposed rule change. Rothwell speculated that FINRA looks through the unit to value the individual components and ascribe an additional value to the warrant within the unit even though the purchaser may have paid the same price for the unit as the public offering price. Rothwell stated that the unit security should instead be valued as a non-convertible security (as the unit is a security that does not itself have an exercise or conversion price) and that the unit securities should have a zero value and should not be ascribed an additional value when a participating member acquires a non-convertible unit at the same price as the public offering price of the unit. FINRA has previously provided guidance, with accompanying examples, for valuing unit securities.[147] This guidance remains valid and illustrative. FINRA does not agree with the commenter's proposed approach to valuing unit securities because a unit given to an underwriter may include a warrant with unique terms, which should be considered in evaluating underwriting compensation.

Numerical Stock Limit

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 10 percent of the number or dollar

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[147] See Notice to Members 92-28 (May 1992).

amount of securities being offered to the public. FINRA eliminated this requirement as unnecessary as the convertible securities valuation formula in current Rule 5110 results in a de facto stock numerical limit.[148] Given the proposed elimination of the convertible securities valuation formula in the Notice 17-15 Proposal, that Proposal requested comment on whether a new stock numerical limit should be included in Rule 5110.

NASAA suggested reinstating the numerical stock limit if FINRA determines to eliminate the convertible securities valuation formula. Rothwell stated that FINRA should not now impose a limit in a manner that would artificially restrict permissible venture, lending and other services that benefit corporate financing clients. Rothwell also stated that any numerical restriction on private placement purchases by a member or affiliate of the securities of the issuer would be contrary to the interest of issuers that look to the FINRA members that will participate in its public offering to also purchase a significant portion of any pre-IPO private placement. Similarly, Rothwell stated that the customers of such members that purchase pre-IPO private placement securities generally expect that the member will share the risk of the investment by being a co-investor. With respect to securities acquired in venture and lending activities where the participating member must take a significant financial investment, Rothwell stated that the current requirements of Rule 5110 have and will continue to effectively limit the amount of securities acquired as underwriting compensation.

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148 See Securities Exchange Act Release No. 48989 (December 23, 2003), 68 FR 75684 (December 31, 2003) (Order Approving File No. SR-NASD-2000-04). See also Notice to Members 04-13 (February 2004).

Because the proposed rule change would retain the current Rule 5110 formula for valuing options, warrants and convertible securities, the proposed rule change does not incorporate a new stock numerical limit.

Exemptive Relief

As set forth in the Notice 17-15 Proposal, Rule 5110 would have been amended to provide that FINRA may in exceptional and unusual circumstances exempt a member from any or all or the provisions in the Rule that FINRA deems appropriate in lieu of the current approach that appropriate FINRA staff, for good cause shown may grant a conditional or unconditional exemption from any of the Rule's provisions. Two commenters questioned whether the change from the exemptive relief provision in the current Rule is intended to limit the circumstances in which an exemption may be sought.[149]

The Notice 17-15 Proposal would have amended the exemptive relief provision in Rule 5110 to be consistent with the exemptive relief provision in the more recently amended Rule 5121. Because the change was not intended to alter the circumstances in which exemptive relief may be sought, the proposed rule change would revert to the language in current Rule 5110 to avoid any confusion regarding the granting of exemptive relief.

Non-Cash Compensation

While acknowledging that the non-cash compensation-related provisions in the Notice 17-15 Proposal are also in the current Rule, SIFMA recommended clarifying these provisions and eliminating inherent inconsistencies between the provisions and the rest of

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149 See ABA and SIFMA.

the Rule. To this end, SIFMA suggested revising proposed Rule 5110(f)(2) to state "in connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision, 'or as permitted elsewhere in this Rule.'" Alternatively, SIFMA suggested adding guidance in the Supplementary Material providing that the receipt of non-cash compensation items (including securities, derivatives and ROFRs) that are permitted under other provisions of Rule 5110 will not be prohibited by, or deemed inconsistent with, the restrictions in Rule 5110(g).

ABA also suggested addressing Rule 5110's non-cash compensation-related provisions in this proposed rule change. ABA suggested that if applied literally, the non-cash compensation provisions state that members may not receive any non-cash compensation other than those limited items set forth in the provision itself, and those items do not include certain forms of non-cash compensation such as securities, derivative instruments or ROFRs that are expressly permitted elsewhere in the Rule.

Consistent with the Notice 17-15 Proposal, because the provisions are the subject of a separate consolidated approach to non-cash compensation, the proposed rule change would incorporate the Rule's current non-cash compensation provisions without modification.

Rule 5121

ABA suggested some clarifications and amendments to Rule 5121. Because any substantive changes to Rule 5121 are more appropriately considered as part of FINRA's separate consideration of our rules and programs governing the capital raising process and their effects on capital formation, this proposed rule change does not include any amendments to Rule 5121 beyond the conforming definitional amendments discussed above.

Regulation A+

ADISA stated that FINRA should be more responsive to the review and clearance of filings made pursuant to SEC Regulation A+ as extensive and long reviews of those offerings have impacted members' ability to effectively raise capital through the public markets. FINRA will continue to review our internal operations and administrative processes to improve the review and clearing of these filings. Separate from this proposed rule change, FINRA will consider the appropriateness of issuing guidance regarding underwriting and related services and financial services provided to issuers in offerings pursuant to Regulation A+.

Guidance

EGS requested that the Public Offering Frequently Asked Questions available on FINRA's website be enhanced and that FINRA publish informal interpretations more broadly and circulate guidance to members and their counsel more frequently. If the proposed rule change is approved, FINRA will consider providing additional guidance as necessary and appropriate.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2019-012 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2019-012. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2019-012 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[150]

Eduardo A. Aleman
Deputy Secretary

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[150] 17 CFR 200.30-3(a)(12).

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*.

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

FINRA
Financial Industry Regulatory Authority

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.

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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.

Regulatory Notice 17-15

Attachment A

Below is the text of the proposed rule change.

* * * * *

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) Requirements for Public Offerings

(1) General

(A) No member or person associated with a member shall participate in a public offering in which the terms and conditions relating thereto, including the aggregate amount of underwriting compensation, are unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any rule or regulation of FINRA.

(B) Any member acting as a managing underwriter or in a similar capacity must notify the other members participating in the public offering if the underwriting terms and arrangements are unfair and unreasonable and the proposed terms and arrangements have not been appropriately modified.

(C) No member may engage in the distribution or sale of securities in any public offering required to be filed by this Rule, Rule 2310 or Rule 5121 unless:

(i) documents and information specified in paragraph (a)(4) have been filed with FINRA; and

(ii) FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.

(2) Offerings Required to be Filed

All public offerings in which a member participates must be filed with FINRA for review, except as exempted from the filing requirement under paragraph (g).

(3) Timely Filing Requirements

(A) A member that participates in a public offering that is required to be filed under paragraph (a)(2) must file the documents and information specified in paragraph (a)(4):

(i) no later than three business days after any documents are filed with or submitted to:

a. the SEC, including confidential filings or submissions; or

b. any state securities commission or other similar U.S. regulatory authority; or

(ii) if not filed with or submitted to any such regulatory authority, at least 15 business days prior to the commencement of sales.

(B) A member that participates in a public offering is not required to make a filing if the filing has been made by a member that is responsible for managing the offering or by another member that is in the syndicate or selling group.

(4) Documents and Information Required to be Filed

(A) The following documents required to be filed under paragraph (a) must be filed in FINRA's Public Offering System for review:

(i) the registration statement, offering circular, offering memorandum, notification of filing, notice of intention, application for conversion, and any other document used to offer securities to the public;

(ii) all documents relevant to the underwriting terms and arrangements, including any proposed underwriting agreement, agreement among underwriters, selected dealers agreement, agency agreement, purchase agreement, letter of intent, engagement letter, consulting agreement, partnership agreement, underwriter's warrant agreement, or escrow agreement, provided that industry-standard master forms of agreement need not be filed unless otherwise specifically requested by FINRA;

(iii) if amendments to any documents previously filed contain changes to the offering and the underwriting terms and arrangements for the public offering, marked pages showing the changes to such document;

(iv) the final registration statement declared effective by the SEC, or the equivalent final offering document, the notice of effectiveness issued by the SEC or any other U.S. regulatory authority, the executed form of the final distribution-related documents and any other document submitted to FINRA for review, each if applicable; and

(v) all requests for withdrawal filed with or submitted to the SEC or any other U.S. regulatory authority, including any correspondence submitted to the SEC for the withdrawal of confidential filings or submissions.

(B) Any member filing documents with FINRA pursuant to paragraph (a)(4)(A) must file the following information with respect to the offering in FINRA's Public Offering System:

(i) an estimate of the maximum public offering price;

(ii) an estimate of the maximum value for each item of underwriting compensation;

(iii) a description of the methodology used to value any security received or to be received as underwriting compensation;

(iv) a representation as to whether any officer or director of the issuer and any beneficial owner of 5% or more of any class of the issuer's equity and equity-linked securities is an associated person or affiliate of a participating member;

(v) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:

a. non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering must be filed and also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price; and

b. non-convertible or non-exchangeable debt securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering.

(vi) if applicable, a representation of compliance with all of the criteria for any exception from underwriting compensation provided in paragraph (c); and

(vii) a detailed explanation and all documents related to the modification of any information or representation previously provided to FINRA during the review period, whether or not FINRA has issued a no objections opinion.

(C) In the event an offering filed pursuant to this Rule is not completed according to the terms of an agreement entered into by the issuer and a participating member, any member receiving underwriting compensation must provide written notification to FINRA of all underwriting compensation received or to be received pursuant to paragraph (f)(4), including a copy of any agreement governing the arrangement.

(D) FINRA will provide confidential treatment to all documents and information filed pursuant to this Rule and use such documents and information solely for the purpose of review in connection with applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

(b) Disclosure Requirements for Underwriting Compensation

(1) A description of each item of underwriting compensation received or to be received by a participating member, including the maximum aggregate amount of all

underwriting compensation, must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Any underwriting compensation consisting of a commission or discount to the public offering price must be disclosed on the cover page of the prospectus or similar document. If the underwriting compensation includes items of compensation in addition to the commission or discount disclosed on the cover page of the prospectus or similar document, a footnote to the offering proceeds table on the cover page of the prospectus or similar document shall include a cross-reference to the section on distribution arrangements.

(c) Securities Acquisitions Not Considered Underwriting Compensation

Securities acquired in transactions that meet the requirements of this paragraph (c) are excluded from underwriting compensation and not subject to the lock-up requirements of paragraph (d)(1), provided that the member does not condition its participation in the public offering on an acquisition of securities in a transaction that meets the requirements of this paragraph and any securities acquired are acquired at the same price and with the same terms as the securities purchased by all other investors.

(1) Purchases and Loans *by* Certain Affiliates — Securities of the issuer purchased in a private placement or received as compensation in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph (a) by a participating member's affiliate, if:

(A) the affiliate is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(B) the investment and loan were made subject to the evaluation of individuals who have a contractual or fiduciary duty to select investments and loans based on the risks and rewards to the affiliate and not based on opportunities for the member participating in the offering to earn investment banking revenues;

(C) the affiliate does not receive investment banking fees paid to any participating member for underwriting public offerings;

(D) the affiliate, directly or through a subsidiary it controls, is primarily engaged in the business of making investments in or loans to other companies; and

(E) the affiliate either:

(i) manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;

(ii) manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;

(iii) is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or

(iv) is a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this Rule.

(2) Investments *in* and Loans *to* Certain Issuers — Securities of the issuer purchased in a private placement or received as compensation in connection with the

provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph (a) by a participating member's affiliate if:

(A) the affiliate:

(i) manages capital contributions or commitments of at least $50 million;

(ii) is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(iii) does not receive investment banking fees paid to any participating member for underwriting public offerings; and

(iv) directly or through a subsidiary it controls, is primarily engaged in the business of making investments in or loans to other companies;

(B) institutional investors beneficially own at least 33% of the issuer's total equity securities, calculated immediately prior to the transaction; and

(C) the transaction was approved by a majority of the issuer's board of directors (if the issuer has a board of directors) and a majority of any institutional investors, or the designees of institutional investors, that are board members.

(3) Private Placements with Institutional Investors — Securities of the issuer purchased in, or received as placement agent compensation in connection with, a private placement before the required filing date of the public offering pursuant to paragraph (a) if:

(A) institutional investors purchase at least 51% of the "total offering" (composed of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member participating in the offering);

(B) an institutional investor was the lead negotiator or, if the terms were not negotiated, was the lead investor with the issuer to establish or approve the terms of the private placement; and

(C) the participating members did not, in the aggregate, purchase or receive as placement agent compensation more than 40% of the "total offering" (excluding purchases by any affiliate qualified under paragraph (c)(1)).

(d) Lock-Up Restriction on Securities

(1) Lock-Up Restriction

(A) Any underwriting compensation consisting of securities must not be sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities for a period of 180 days beginning on the date of commencement of sales of the public offering, except as provided in paragraph (d)(2).

(B) The lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (d)(1):

(A) the lock-up restriction will not apply if:

(i) the security is required to be transferred by operation of law or by reason of reorganization of the issuer;

(ii) the aggregate amount of securities of the issuer beneficially owned by a participating member does not exceed 1% of the securities being offered;

(iii) the security is of an issuer that meets the registration requirements of SEC Registration Forms S-3, F-3 or F-10; or

(iv) the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that no participating member manages or otherwise directs investments by the fund, and participating members in the aggregate do not own more than 10% of the equity in the fund.

(B) the following will not be prohibited:

(i) the transfer of any security to any member participating in the offering and its officers or partners, its registered persons or affiliates, if all transferred securities remain subject to the lock-up restriction in paragraph (d)(1) for the remainder of the 180-day lock-up period;

(ii) the exercise or conversion of any security, if all securities received remain subject to the lock-up restriction in paragraph (d)(1) for the remainder of the 180-day lock-up period; or

(iii) the transfer or sale of the security back to the issuer in a transaction exempt from registration with the SEC.

(e) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" as used in this paragraph (e) shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors[1] and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

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[1] The current annual amount fixed by the Board of Governors is $100.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (e)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (e)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (e)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (e)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraphs (e)(2)(C) through (E).

(f) Unreasonable Terms and Arrangements

Without limiting the requirements of paragraph (a)(1)(A), the following terms and arrangements are prohibited:

(1) receipt of any underwriting compensation, including in the form of securities, for which a value cannot be determined;

(2) any accountable expense allowance that includes payment for general overhead, salaries, supplies, or similar expenses incurred in the normal conduct of business;

(3) any underwriting compensation paid prior to the commencement of sales of the public offering, except an advance against accountable expenses actually anticipated to be incurred, which must be reimbursed to the issuer to the extent not actually incurred;

(4) any underwriting compensation in connection with a public offering that is not completed according to the terms of an agreement entered into by an issuer and a participating member, except:

(A) the reimbursement of accountable expenses actually incurred by the participating member; and

(B) a termination fee or a right of first refusal, as set forth in a written agreement entered into by an issuer and a participating member, provided that:

(i) the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement;

(ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal;

(iii) the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv) the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer.

(5) any right of first refusal to participate in the distribution of a future public offering, private placement or other financing that:

(A) has a duration of more than three years from the commencement of sales of the public offering or the termination date of the engagement between the issuer and member; or

(B) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee;

(6) any payment or fee to waive or terminate a right of first refusal to participate in a future public offering, private placement or other financing that is not paid in cash;

(7) the receipt of underwriting compensation consisting of any option, warrant or convertible security that:

(A) is exercisable or convertible more than five years from the commencement of sales of the public offering;

(B) has more than one demand registration right at the issuer's expense;

(C) has a demand registration right with a duration of more than five years from the commencement of sales of the public offering;

(D) has a piggyback registration right with a duration of more than seven years from the commencement of sales of the public offering;

(E) has anti-dilution terms that allow the participating members to receive more shares or to exercise at a lower price than originally agreed upon at the time of the public offering, when the public shareholders have not been proportionally affected by a stock split, stock dividend, or other similar event; or

(F) has anti-dilution terms that allow the participating members to receive or accrue cash dividends prior to the exercise or conversion of the security;

(8) when proposed in connection with the distribution of a public offering of securities on a "firm commitment" basis, any overallotment option providing for the overallotment of more than 15% of the amount of securities being offered, computed excluding any securities offered pursuant to the overallotment option;

(9) the receipt by a participating member of any compensation in connection with the exercise or conversion of any warrant, option, or convertible security offered in the public offering if:

(A) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

(B) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion, except where prior specific written approval for exercise or conversion is received from the customer;

(C) the compensation arrangements are not disclosed in the offering documents provided to security holders at the time of exercise or conversion;

(D) the exercise or conversion is not solicited by the participating members; and

(10) for a member to participate with an issuer in the public offering of securities if the issuer hires persons primarily for the purpose of solicitation, marketing, distribution

or sales of the offering, except in compliance with Section 15(a) of the Exchange Act or SEA Rule 3a4-1 and applicable state law.

(g) Exemptions

(1) Offerings Exempt from Filing

Documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of Rule 5121(a)(2), provided that the following public offerings must comply with this Rule and, if applicable, Rules 2310 and 5121:

(A) securities offered by a bank, corporation, foreign government or foreign government agency that has unsecured non-convertible debt with a term of issue of at least four years or unsecured non-convertible preferred securities that are investment grade rated, as defined in Rule 5121(f)(8), or are securities in the same series that have equal rights and obligations as investment grade rated securities, provided that an initial public offering of equity is required to be filed;

(B) investment grade rated non-convertible debt securities and non-convertible preferred securities;

(C) offerings of securities registered with the SEC on registration statement Forms S-3, F-3, or F-10, provided that the registrant is an experienced issuer;

(D) investment grade rated financing instrument-backed securities;

(E) exchange offers where:

(i) the securities to be issued or the securities of the company being acquired are listed on a national securities exchange as defined in Section 6 of the Exchange Act; or

(ii) the company issuing securities qualifies to register securities with the SEC on registration statement Forms S-3, F-3, or F-10 and is an experienced issuer;

(F) public offerings of securities by a church or other charitable institution that is exempt from SEC registration pursuant to Section 3(a)(4) of the Securities Act;

(G) offerings of securities issued by a pooled investment vehicle, whether formed as a trust, partnership, corporation, limited liability company or other collective investment vehicle, that is not registered as an investment company under the Investment Company Act and has a class of equity securities listed for trading on a national securities exchange and that may be created or redeemed on any business day at their net asset value per share; and

(H) offerings of securities by a "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that is operated as a tender offer fund, provided that the fund:

(i) makes continuous offerings pursuant to Securities Act Rule 415;

(ii) prices its securities monthly;

(iii) limits the total amount of compensation paid to participating members to the amount permitted by the sales charge limitations of Rule

2341, in which case the underwriting compensation provisions of Rule 5110 will not apply;

(iv) makes at least two repurchase offers per calendar year for its securities pursuant to SEA Rule 13e-4 and Schedule TO under the Exchange Act;

(v) does not list its securities on a national securities exchange; and

(vi) files its initial public offering of equity with FINRA.

(2) Offerings Not Subject to Filing and Rule Compliance

The following offerings are not subject to this Rule, Rule 2310 and Rule 5121 including not being required to file documents and information for review:

(A) securities exempt from registration with the SEC pursuant to the provisions of Sections 4(a)(1), 4(a)(2) or 4(a)(6) of the Securities Act;

(B) securities exempt from registration with the SEC pursuant to Rule 504 of SEC Regulation D if the securities are restricted securities under Securities Act Rule 144(a)(3) or Rule 506 of SEC Regulation D;

(C) securities exempt from registration with the SEC pursuant to Securities Act Rule 144A or SEC Regulation S;

(D) securities which are defined as "exempted securities" in Section 3(a)(12) of the Exchange Act;

(E) securities of "open-end" investment companies as defined in Section 5(a)(1) of the Investment Company Act;

(F) securities of any "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) of SEC Regulation C;

(G) variable contracts as defined in Rule 2320(b)(2);

(H) modified guaranteed annuity contracts and modified guaranteed life insurance policies, which are deferred annuity contracts or life insurance policies the value of which are guaranteed if held for specified periods, and the nonforfeiture value of which are based upon a market-value adjustment formula for withdrawals made before the end of any specified period;

(I) insurance contracts not otherwise included in paragraphs (g)(2)(G) and (H);

(J) municipal securities as defined in Section 3(a)(29) of the Exchange Act;

(K) tender offers made pursuant to SEC Regulation 14D under the Exchange Act;

(L) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act;

(M) securities of a subsidiary or other affiliate distributed by a company in a spin-off or reverse spin-off or similar transaction to its existing security holders exclusively as a dividend or other distribution;

(N) securities registered with the SEC in connection with a merger or acquisition transaction or other similar business combination, except for any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; and

(O) securities of a unit investment trust as defined in Section 4(2) of the Investment Company Act.

(h) Requests for Rule 9600 Exemption from Rule 5110

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate.

(i) Definitions

The definitions in Rule 5121 are incorporated herein by reference. For the purposes of this Rule, the following terms have the meanings stated below:

(1) Associated Person

The term "associated person" has the meaning defined in Article I, Section (rr) of the FINRA By-Laws.

(2) Bank

For the purposes of paragraph (c), the term "bank" refers only to the regulated entity, not its subsidiaries or other affiliates.

(3) Company

The term "company" means a corporation, a partnership, an association, a joint stock company, a trust, a fund, or an organized group of persons whether incorporated or not; including any receiver, trustee in bankruptcy or similar official, or liquidating agent of any of the foregoing.

(4) Compensation

The term "compensation" means cash compensation and non-cash compensation.

(5) Effective Date

The term "effective date" means the date on which an issue of securities becomes legally eligible for distribution to the public.

(6) Experienced Issuer

The term "experienced issuer" means an entity that has:

(A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and

(B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

(7) Equity-Linked Securities

The term "equity-linked securities" means any security that is convertible or exchangeable into an equity security.

(8) Immediate Family

The term "immediate family" means:

(A) the spouse or child of an associated person of a member; and

(B) any relative who either lives in the same household as, has a business relationship with, provides material support to, or receives material support from, an associated person of a member, including, but not limited to, a parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

(9) Independent Financial Adviser

The term "independent financial adviser" means a member or a person affiliated or associated with a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated or associated with any entity that is engaged in, the solicitation or distribution of the offering.

(10) Institutional Investor

For the purposes of paragraph (c), the term "institutional investor" means any person that has an aggregate of at least $50 million invested in securities in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members manage the institutional investor's investments or have an equity interest in the institutional investor, either individually or in the aggregate, that exceeds 5% for a publicly owned entity or 1% for a nonpublic entity.

(11) Insurance Company

For the purposes of paragraph (c), the term "insurance company" refers only to the regulated entity, not its subsidiaries or other affiliates.

(12) Issuer

The term "issuer" means an entity that is offering its securities to the public, registrant, any selling security holder offering securities to the public, any affiliate of the entity or selling security holder, and the officers or general partners, and directors thereof.

(13) Offering Proceeds

The term "offering proceeds" means the proceeds of all the securities offered in the public offering by participating members, not including securities subject to an overallotment option, securities to be received by the participating members, or underlying securities.

(14) Overallotment Option

The term "overallotment option" means an option granted by the issuer to the participating members for the purpose of offering additional shares to the public in connection with the distribution of the public offering.

(15) Participating Member

The term "participating member" means 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.

(16) Participate, Participation or Participating

The terms "participate," "participation" or "participating" in a public offering means involvement in the preparation of the offering document or other documents, involvement in the distribution of the offering, furnishing of customer or broker lists for solicitation, or providing advisory or consulting services to the issuer related to the offering, but not including:

(A) the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEA Rule 13e-3; and

(B) advisory or consulting services provided to the issuer by an independent financial adviser, provided that another member or members are participating in the public offering.

(17) Person

The term "person" means any natural person, partnership, corporation, company, association, or other legal entity.

(18) Public Offering

The term "public offering" means any primary or secondary offering of securities made pursuant to a registration statement, offering circular or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition.

(19) Required Filing Date

(A) The term "required filing date" means the dates referenced in paragraph (a)(3); and

(B) For a public offering exempt from filing under paragraph (g), the term "required filing date" means the date the public offering would have been required to be filed with FINRA but for the exemption.

(20) Review Period

The term "review period" means:

(A) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering;

(B) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and

(C) for a firm commitment or best efforts takedown or any other continuous offering on behalf of selling securityholders made pursuant to Securities Act Rule 415, the 180-day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.

(21) Total Equity Securities

For the purposes of paragraph (c), the term "total equity securities" means the aggregate of the total shares of:

(A) common stock outstanding of the issuer; and

(B) common stock of the issuer underlying all convertible securities outstanding that convert without the payment of any additional consideration.

(22) Underwriting Compensation

The term "underwriting compensation" means 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. In addition, underwriting compensation shall include finder fees, and underwriter's counsel fees, including expense reimbursements and securities.

• • • Supplementary Material: --------------

.01 Underwriting Compensation.

(a) The following are examples of payments or benefits that are considered underwriting compensation:

(1) discounts or commissions;

(2) fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses;

(3) fees and expenses of counsel to participating members (except for reimbursement of "blue sky" fees);

(4) finder fees;

(5) wholesaling fees and expenses;

(6) financial consulting and advisory fees;

(7) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, beneficially owned, as defined in Rule 5121 by the participating members the value of which is determined pursuant to this Rule, and acquired during the review period, as defined in this Rule;

(8) sales incentive items;

(9) any right or rights of first refusal provided to any participating member to participate in future public offerings, private placements or other financings, the value of which will be 1% of the offering proceeds or a dollar amount contractually agreed to by the issuer and the participating member to waive the right of first refusal;

(10) compensation to be received by a participating member or by any person nominated by the participating member as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;

(11) any compensation to be received by the participating members as a result of the exercise or conversion of warrants, options, convertible securities, or similar securities distributed as part of the public offering within 12 months following the commencement of sales;

(12) fees of a qualified independent underwriter required by Rule 5121;

(13) any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering; and

(14) non-cash compensation, such as gifts, training and education expenses, sale incentives, and business entertainment expenses.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; fees of independent financial advisers; and accountant's fees, and other fees and expenses customarily borne by an issuer, whether or not paid by or through a participating member;

(2) cash compensation for acting as placement agent for a private placement or for providing or arranging for a loan, credit facility, or for services in connection with a merger or acquisition;

(3) records management and advisory fees and expenses in connection with the conversion of the issuer from a mutual holding company to a stock holding company;

(4) payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer;

(5) compensation for providing brokerage, trust and insurance services to the issuer that is received in the ordinary course of business;

(6) fees for commercial banking services that do not require registration as a broker-dealer, provided to the issuer in the ordinary course of business;

(7) compensation for providing services in a prior or concurrent public offering separately filed or exempt from filing pursuant to this Rule;

(8) a right of first refusal that is provided to a participating member in connection with a prior financing if the right of first refusal does not extend beyond the initial closing of the public offering currently under review or if the right of first refusal has already been included as underwriting compensation in a prior or concurrent public offering;

(9) dividends paid to shareholders of a class of the issuer's securities when participating members are shareholders of that class;

(10) securities of the issuer pledged as collateral for a bona fide loan;

(11) listed securities purchased in public market transactions;

(12) compensation received through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code or a similar plan;

(13) securities acquired by an investment company registered under the Investment Company Act;

(14) securities acquired as the result of a conversion of securities that were originally acquired prior to the review period;

(15) securities acquired as the result of an exercise of options or warrants that were originally acquired prior to the review period;

(16) securities acquired as the result of a stock-split, a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired prior to the review period;

(17) securities acquired as the result of a right of preemption that was granted prior to the review period;

(18) securities acquired in order to prevent dilution of a long-standing interest in the issuer, if:

(A) the amount of securities does not increase a member's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and

(B) an initial purchase of securities of the issuer was made at least two years preceding the required filing date and a second purchase was made before the review period.

(19) non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) securities acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A; and

(21) securities acquired in the secondary market by a participating member that is a broker-dealer in connection with the performance of bona fide customer facilitation activities; provided that securities acquired from the issuer will be considered "underwriting compensation" if the securities were not acquired at a fair price (taking into account, among other things customary commissions, mark-downs and other charges).

(c) Definitions.

(1) The term "listed securities" means securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S.

(2) The term "right of pre-emption" means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to: (A) any option, shareholder agreement, or other contractual right entered into at the time of purchase of securities; (B) the terms of the securities purchased; (C) the issuer's charter or by-laws; or (D) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.

.02 Valuation of Underwriting Compensation.

The value of non-convertible securities received as underwriting compensation will have a compensation value based on the difference between (i) the public offering price per security; and (ii) the per security cost.

The value of options, warrants and other convertible securities received as underwriting compensation must 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. Consideration paid by the participating member to acquire such securities will be taken into account and credited against the value as so calculated.

If a participating member wishes to reduce the proposed maximum value of any securities received as underwriting compensation, they may do so by voluntarily agreeing to lock-up such securities for successive 180-day periods (in addition to the initial lock-up period required by paragraph (d) of this Rule if applicable). Each additional 180-day period will reduce the proposed maximum value attributable to such securities by 10%.

.03 Disclosure of Underwriting Compensation. A description of each item of underwriting compensation received or to be received by a participating member, including the maximum aggregate amount of all underwriting compensation, must be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document). The description need not include the dollar amount ascribed to each individual item of compensation (other than the underwriting discounts or commissions). When securities are acquired by a participating member, material terms and arrangements of the acquisition must also be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document) when applicable, such as exercise terms, demand and piggyback registration rights and lock-up periods that may apply. Similarly, if underwriting compensation consists of a right of first refusal to participate in the distribution of a future public offering, private placement or other financing, the description should reference the existence of such right and its duration. The 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.

.04 Non-Convertible or Non-Exchangeable Debt Securities and Derivatives.

(a) Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation value. Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule and members must provide a description of the methodology used to value the security as required by paragraph (a)(4)(B)(iii) of this Rule.

(b) The term "derivative instrument" means any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term "fair price" means the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm's length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services, is not included within this fair price definition.

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5121. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraphs (1) or (2).

(1) There must be prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering, and one of the following conditions must be met:

(A) the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(11)(E);

(B) the securities offered have a bona fide public market; or

(C) the securities offered are investment grade rated or are securities in the same series that have equal rights and obligations as investment grade rated securities.

(2) (A) A qualified independent underwriter has participated in the preparation of the registration statement and the prospectus, offering circular, or similar document and has exercised the usual standards of "due diligence" in respect thereto; and

(B) there must be prominent disclosure in the prospectus, offering circular or similar document for the offering of:

(i) the nature of the conflict of interest;

(ii) the name of the member acting as qualified independent underwriter; and

(iii) a brief statement regarding the role and responsibilities of the qualified independent underwriter.

(b) Escrow of Proceeds; Net Capital Computation

(1) All proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with subparagraph (2) hereof.

(2) Any member offering its securities pursuant to this Rule shall immediately notify FINRA when the public offering has been terminated and settlement effected and shall file with FINRA a computation of its net capital computed pursuant to the provisions of SEA Rule 15c3-1 (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the member calculates its net capital requirement using the alternative standard (set forth in Rule 15c3-1(a)(1)(ii)), its net capital is less than seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, all monies received from sales of securities of the public offering must be returned in full to the purchasers thereof and the offering withdrawn, unless the member has obtained from the SEC a specific exemption from the net capital rule. Proceeds from the sales of securities in the public offering may be taken into consideration in computing net capital ratio for purposes of this paragraph.

(3) Any member offering its securities pursuant to this Rule shall disclose in the registration statement, offering circular or similar document a date by which the offering is reasonably expected to be completed and the terms upon which the proceeds will be released from the escrow account described in paragraph (b)(1).

(c) Discretionary Accounts

Notwithstanding NASD Rule 2510, no member that has a conflict of interest may sell to a discretionary account any security with respect to which the conflict exists, unless the member has received specific written approval of the transaction from the account holder and retains documentation of the approval in its records.

(d) Application of Rule 5110

Any public offering subject to paragraph (a)(2) is subject to Rule 5110, whether or not the offering would be otherwise exempted from the filing or other requirements of that rule.

(e) Requests for Exemption from Rule 5121

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate.

(f) Definitions

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

(1) Affiliate

The term "affiliate" means an entity that controls, is controlled by or is under common control with a member.

(2) Beneficial Ownership

The term "beneficial ownership" means the right to the economic benefits of a security.

(3) Bona Fide Public Market

The term "bona fide public market" means a market for a security of an issuer that has been reporting under the Exchange Act for at least 90 days and is current in its reporting requirements, and whose securities are traded on a national securities exchange with an Average Daily Trading Volume (as provided by SEC Regulation M) of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million.

(4) Common Equity

The term "common equity" means the total number of shares of common stock outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(5) Conflict of Interest

The term "conflict of interest" means, if at the time of a member's participation in an entity's public offering, any of the following applies:

(A) the securities are to be issued by the member;

(B) the issuer controls, is controlled by or is under common control with the member or the member's associated persons;

(C) at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be:

(i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or

(ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate; or

(D) as a result of the public offering and any transactions contemplated at the time of the public offering:

(i) the member will be an affiliate of the issuer;

(ii) the member will become publicly owned; or

(iii) the issuer will become a member or form a broker-dealer subsidiary.

(6) Control

(A) The term "control" means:

(i) beneficial ownership of 10 percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member's participation in the public offering;

(ii) the right to 10 percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering;

(iii) beneficial ownership of 10 percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or

(iv) the power to direct or cause the direction of the management or policies of an entity.

(B) The term "common control" means the same natural person or entity controls two or more entities.

(7) Entity

For purposes of the definitions of affiliate, conflict of interest and control under this Rule, the term "entity":

(A) includes a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons; and

(B) excludes the following:

(i) an investment company registered under the Investment Company Act;

(ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act;

(iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code; or

(iv) a "direct participation program" as defined in Rule 2310.

(8) Investment Grade Rated

The term "investment grade rated" refers to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

(9) Preferred Equity

The term "preferred equity" means the aggregate capital invested by all persons in the preferred securities outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(10) Prominent Disclosure

A member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B) by:

(A) providing the notation "(Conflicts of Interest)" following the listing of the Plan of Distribution in the Table of Contents section required in Item 502 of SEC Regulation S-K, and by providing such disclosures in the Plan of Distribution section required in Item 508 of SEC Regulation S-K and any Prospectus Summary section required in Item 503 of SEC Regulation S-K; or

(B) for an offering document not subject to SEC Regulation S-K, by providing disclosure on the front page of the offering document that a conflict exists, with a cross-reference to the discussion within the offering document and in the summary of the offering document if one is included.

(11) Qualified Independent Underwriter

The term "qualified independent underwriter" means a member:

(A) that does not have a conflict of interest and is not an affiliate of any member that has a conflict of interest;

(B) that does not beneficially own as of the date of the member's participation in the public offering, more than 5% of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days;

(C) that has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act, specifically including those inherent in Section 11 thereof; and

(D) that has served as underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering without a registration statement. This requirement will be deemed satisfied if, during the past three years, the member:

(i) with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering; and

(ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering.

(E) none of whose associated persons in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) has been convicted within ten years prior to the filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;

(ii) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or

(iii) has been suspended or barred from association with any member by an order or decision of the SEC, any state, FINRA or any other self-regulatory organization within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.

(12) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act; notification on Form 1A filed with the SEC pursuant to the provisions of Securities Act Rule 252; or any other document, by whatever name known, initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any federal or state agency.

(13) Subordinated Debt

The term "subordinated debt" includes (A) debt of an issuer which is expressly subordinate in right of payment to, or with a claim on assets subordinate to, any existing or future debt of such issuer; or (B) all debt that is specified as subordinated at the time of issuance. Subordinated debt shall not include short-term debt with maturity at issuance of less than one year and secured debt and bank debt not specified as subordinated debt at the time of issuance.

* * * * *

Regulatory Notice 17-15

Attachment B

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

[(a) Definitions redesignated as paragraph (i) and alphabetized]

* * * * *

[(2) Net Offering Proceeds]

[Offering proceeds less all expenses of issuance and distribution.]

* * * * *

[(6) Underwriter and Related Persons]

[Consists of underwriter's counsel, financial consultants and advisors, finders, any participating member, and any other persons related to any participating member.]

[(7) Listed Securities]

[securities meeting the listing standards to trade on the national securities exchanges identified in Securities Act Rule 146, markets registered with the SEC under Section 6 of the Exchange Act, and any offshore market that is a "designated offshore securities market" under Rule 902(b) of SEC Regulation S.]

[(8) Derivative Instruments]

[A derivative instrument is any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3).]

[(9) Fair Price]

[A derivative instrument or non-convertible or non-exchangeable debt security has been acquired or entered into at a fair price for purposes of paragraphs (b)(6)(A)(iv), (c)(3)(B)(vi) and (vii), and (e)(5) if the underwriters and related persons have priced the debt security or derivative instrument in good faith; on an arm's length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services, is not included within this "fair price" definition.]

* * * * *

[(b)]<u>(a)</u> [Filing] Requirements <u>for Public Offerings</u>

(1) General

[(f)(1)]<u>(A)</u> No member or person associated with a member shall participate [in any manner] in a public offering [of securities after any arrangement proposed in connection with the public offering, or the] <u>in which the</u> terms and conditions relating thereto, <u>including the aggregate amount of underwriting compensation,</u> [has been determined to be] <u>are</u> unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any rule or regulation of FINRA.

<u>(B) Any member acting as a managing underwriter or in a similar capacity must notify the other members participating in the public offering if the underwriting terms and arrangements are unfair and unreasonable</u>

and the proposed terms and arrangements have not been appropriately modified.

(C) No member [or person associated with a member shall participate in any manner] may engage in the distribution or sale of securities in any public offering [of securities subject to] required to be filed by this Rule, Rule 2310 or Rule 5121 unless:

(i) documents and information [as] specified [herein relating to the offering] in paragraph (a)(4) have been filed with [and reviewed by] FINRA[.]; and

(ii) FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.

[(2) Means of Filing]

[Documents or information required by this Rule to be filed with FINRA shall be considered to be filed only upon receipt by its Corporate Financing Department.]

[(b)(3) redesignated as paragraph (a)(4)(D)]

[(9)](2) Offerings Required to be Filed

All public offerings in which a member participates must be filed with FINRA for review, except as exempted from the filing requirement under paragraph (g).

[Documents and information relating to all other public offerings including, but not limited to, the following must be filed with FINRA for review:]

[(A) direct participation programs as defined in Rule 2310(a);]

[(B) mortgage and real estate investment trusts;]

[(C) rights offerings;]

[(D) securities exempt from registration with the SEC pursuant to Section 3(a)(11) of the Securities Act;]

[(E) securities exempt from registration with the SEC pursuant to Rule 504 of SEC Regulation D, unless the securities are "restricted securities" under Securities Act Rule 144(a)(3);]

[(F) securities offered by a bank, savings and loan association, or common carrier even though such offering may be exempt from registration with the SEC;]

[(G) securities offered pursuant to SEC Regulation A;]

[(H) exchange offers that are exempt from registration with the SEC under Sections 3(a)(4), 3(a)(9), or 3(a)(11) of the Securities Act (if a member's participation involves active solicitation activities) or registered with the SEC (if a member is acting as dealer-manager) (collectively "exchange offers"), except for exchange offers exempt from filing pursuant to subparagraph (7)(F) above that are not subject to filing by subparagraph (9)(I) below;]

[(I) any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; and]

[(J) any offerings of a similar nature that are not exempt under subparagraph (7) or (8) above.]

[(4)]<u>(3)</u> [Requirement for Filing]<u>Timely Filing Requirements</u>

(A) [Unless filed by the issuer, the managing underwriter, or another member, a] <u>A</u> member that [anticipates participating] <u>participates</u> in a public offering [of securities subject to this Rule shall] <u>that is required to be filed under paragraph (a)(2) must</u> file [with FINRA] the documents and information [with respect to the offering] specified in [sub]paragraph[s] <u>(a)</u>(<u>4</u>[5]) [and (6) below]:

(i) no later than [one] <u>three</u> business day<u>s</u> after any [of such] documents are filed with or submitted to:

a. the SEC<u>, including confidential filings or submissions</u>; or

b. any state securities commission or other <u>similar U.S.</u> regulatory authority; or

(ii) if not filed with or submitted to any <u>such</u> regulatory authority, at least [fifteen]<u>15</u> business days prior to the [anticipated date on which offers will commence] commencement of sales.

(B) <u>A member that participates in a public offering is not required to make a filing if the filing has been made by a member that is responsible for managing the offering or by another member that is in the syndicate or selling group.</u>

[No sales of securities subject to this Rule shall commence unless:]

[(i) the documents and information specified in subparagraphs (5) and (6) below have been filed with and reviewed by FINRA; and]

[(ii) FINRA has provided an opinion that it has no objections to the proposed underwriting and other terms and arrangements or an opinion that the proposed underwriting and other terms and arrangements are unfair and unreasonable. If FINRA's opinion states that the proposed underwriting and other terms and arrangements are unfair and unreasonable, the member may file modifications to the proposed underwriting and other terms and arrangements for further review.]

[(C) Any member acting as a managing underwriter or in a similar capacity that has been informed of an opinion by FINRA, or a determination by the appropriate standing committee of the Board of Governors, that the proposed underwriting terms and arrangements of a proposed offering are unfair or unreasonable, and the proposed terms and arrangements have not been modified to conform to the standards of fairness and reasonableness, shall notify all other members proposing to participate in the offering of that opinion or determination at a time sufficiently prior to the effective date of the offering or the commencement of sales so the other members will have an opportunity as a result of specific notice to comply with their obligation not to participate in any way in the distribution of a public offering containing arrangements, terms and conditions that are unfair or unreasonable.]

[(5)](4) Documents and Information Required to be Filed

(A) The following documents [relating to all proposed public offerings of securities that are] required to be filed under paragraph [(b)(4)](a) [above shall] must be filed [through] in FINRA's Public Offering [electronic filing s]System for review:

(i) [T]the registration statement, offering circular, offering memorandum, notification of filing, notice of intention, application for conversion, and[/or] any other document used to offer securities to the public;

(ii) all documents relevant to the underwriting terms and arrangements, including [A]any proposed underwriting agreement, agreement among underwriters, selected dealers agreement, agency agreement, purchase agreement, letter of intent, engagement letter, consulting agreement, partnership agreement, underwriter's warrant agreement, or escrow agreement, provided that industry-standard master forms of agreement need not be filed unless otherwise specifically requested by FINRA [and any other document that describes the underwriting or other arrangements in connection with or related to the distribution, and the terms and conditions relating thereto; and any other information or documents that may be material to or part of the said arrangements, terms and conditions and that may have a bearing on FINRA's review];

(iii) [Each pre- and post-effective amendment to the registration statement or other offering document, with a copy marked to show changes; and any other amended document previously filed pursuant to subparagraphs (i) and (ii) above, with a copy marked to show changes; and] if amendments to any documents previously filed contain changes to the offering and the underwriting terms and arrangements for the public offering, marked pages showing the changes to such document;

(iv) the final registration statement declared effective by the SEC, or the equivalent final offering document, the notice of effectiveness issued by the SEC or any other U.S. regulatory authority, the executed form of the final distribution-related documents and any other document submitted to FINRA for review, each if applicable; and [The final registration statement declared effective by the SEC or equivalent final offering document and a list of the members of the underwriting syndicate, if not indicated therein, and one copy of the executed form of the final underwriting documents and any other document submitted to FINRA for review.]

(v[B]) all requests for withdrawal filed with or submitted to the SEC or any other U.S. regulatory authority, including any correspondence submitted to the SEC for the withdrawal of confidential filings or submissions.

[Documents that are filed with the SEC through the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") System that are referenced in FINRA's electronic filing system shall be treated as filed with FINRA.]

[(6) Information Required to be Filed]

(B[A]) Any [person] member filing documents with FINRA pursuant to [sub]paragraph (a)(4)(A) [above shall] must file [provide] the following information with respect to the offering [through] in FINRA's Public Offering [electronic filing s]System:

(i) an estimate of the maximum public offering price;

(ii) an estimate of the maximum value for each item of underwriting compensation [an estimate of the maximum underwriting discount or commission; maximum reimbursement of underwriter's expenses, and underwriter's counsel's fees (except for reimbursement of "blue sky" fees); maximum financial consulting and/or advisory fees to the underwriter and related persons; maximum finder's fees; and a statement of any other type and amount of compensation which may accrue to the underwriter and related persons];

(iii) a description of the methodology used to value any security received or to be received as underwriting compensation;

(iv) a representation as to whether any officer or director of the issuer and any beneficial owner of 5% or more of any class of the issuer's equity and equity-linked securities is an associated person or affiliate of a participating member;

[(iii) a statement of the association or affiliation with any participating member of any officer or director of the issuer, of any beneficial owner of 5% or more of any class of the issuer's securities, and of any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering, except for purchases described in paragraph (c)(3)(B)(iv) below. This statement must identify:]

[a. the person;]

[b. the member; and]

[c. the number of equity securities or the face value of debt securities owned by such person, the date such securities were acquired, and the price paid for such securities.]

[(iv) a detailed explanation of any other arrangement entered into during the 180-day period immediately preceding the required filing date of the public offering, which arrangement provides for the receipt of any item of value or the transfer of any warrants, options, or other securities from the issuer to the underwriter and related persons, provided however:]

[a. information regarding debt securities and derivative instruments not considered an item of value under paragraphs (c)(3)(B)(vi) and (vii) is not required to be filed; and]

[b. information initially filed in connection with debt securities and derivative instruments acquired or entered into for "fair price" as defined in paragraph (a)(9), but not excluded from items of value under paragraph (c)(3)(B)(vi) or (vii), may be limited to a brief description of the transaction (additional information may be required in the review process) and a representation by the member that a registered principal or senior manager on behalf of the member has determined that the transaction was or (if the pricing terms have not been set) will be entered into at a fair price as defined in paragraph (a)(9).]

<u>(v) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:</u>

<u>a. non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering must be filed and</u>

also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price; and

b. non-convertible or non-exchangeable debt securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering.

[(v) a statement demonstrating compliance with all of the criteria of an exception from underwriting compensation in paragraph (d)(5) below, when applicable; and]

(vi) if applicable, a representation of compliance with all of the criteria for any exception from underwriting compensation provided in paragraph (c); and

(vii) a detailed explanation and all [any] documents related to[:]

[a.] the modification of any information or representation previously provided to FINRA during the review period, whether or not FINRA has issued a no objections opinion. [or of any item of underwriting compensation including the information required in paragraph (b)(6)(A)(iii) above with respect to any securities of the issuer acquired subsequent to the required filing date and prior to the effectiveness or commencement of the offering; or]

[b. any new arrangement that provides for the receipt of any additional item of value by any participating member subsequent to the issuance of an opinion of no objections to the underwriting terms and arrangements by FINRA and within 90 days immediately following the date of effectiveness or commencement of sales of the public offering, provided, however, that information filed in connection with debt securities and derivative instruments acquired or entered into for a "fair price" as defined in paragraph (a)(9) may be limited as described in paragraph (b)(6)(A)(iv)b.]

[(vii) any other information required to be filed under this Rule.]

(C[B]) [Any person filing documents pursuant to paragraph (b)(5) above shall notify FINRA through its electronic filing system that the offering has been declared effective or approved by the SEC or other agency no later than one business day following such declaration or approval or that the offering has been withdrawn or abandoned within three business days following the withdrawal or decision to abandon the offering.]

In the event an offering filed pursuant to this Rule is not completed according to the terms of an agreement entered into by the issuer and a participating member, any member receiving underwriting compensation must provide written notification to FINRA of all underwriting compensation received or to be received pursuant to paragraph (f)(4), including a copy of any agreement governing the arrangement.

[(b)(3)](D) [Confidential Treatment]

FINRA [shall accord] will provide confidential treatment to all documents and information filed pursuant to this Rule and [shall utilize] use such documents and information solely for the purpose of review in connection with [to determine compliance with the provisions of] applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

[(b)(7) and (b)(8) redesignated as paragraphs (g)(1) and (g)(2), respectively]

[(c)](b) Disclosure Requirements for Underwriting Compensation [and Arrangements]

[(1) General]

[No member or person associated with a member shall participate in any manner in any public offering of securities in which the underwriting or other terms or arrangements in connection with or relating to the distribution of the securities, or the terms and conditions related thereto, are unfair or unreasonable.]

[(2) Amount of Underwriting Compensation]

[(A) No member or person associated with a member shall receive an amount of underwriting compensation in connection with a public offering that is unfair or unreasonable and no member or person associated with a member shall underwrite or participate in a public offering of securities if the underwriting compensation in connection with the public offering is unfair or unreasonable.]

[(B) For purposes of determining the amount of underwriting compensation, all items of value received or to be received from any source by the underwriter and related persons which are deemed to be in connection with or related to the distribution of the public offering as determined pursuant to subparagraph (3) below shall be included.]

([C]1) [All items of] A description of each item of underwriting compensation received or to be received by a participating member, including the maximum aggregate amount of all underwriting compensation, must [shall] be disclosed in the section on [underwriting or] distribution arrangements in the prospectus or similar document.

(2) [and, if the underwriting compensation includes items of compensation in addition to the] Any underwriting compensation consisting of a commission or discount to the public offering price must be disclosed on the cover page of the prospectus or similar document[,]. If the underwriting compensation includes items of compensation in addition to the commission or discount disclosed on the cover page of the prospectus or similar document, a footnote to the offering proceeds table on the cover page of the prospectus or

similar document shall include a cross-reference to the section on [underwriting or] distribution arrangements.

[(D) For purposes of determining the currently effective guideline on the maximum amount of underwriting compensation considered fair and reasonable, the following factors, as well as any other relevant factors and circumstances, shall be taken into consideration:]

[(i) the offering proceeds;]

[(ii) the amount of risk assumed by the underwriter and related persons, which is determined by:]

[a. whether the offering is being underwritten on a "firm commitment" or "best efforts" basis and]

[b. whether the offering is an initial or secondary offering; and]

[(iii) the type of securities being offered.]

[(E) The maximum amount of compensation (stated as a percentage of the dollar amount of the offering proceeds) that is considered fair and reasonable generally will vary directly with the amount of risk to be assumed by participating members and inversely with the dollar amount of the offering proceeds.]

[(3) Items of Value]

[(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to paragraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the public offering, as determined pursuant to paragraph (d) below shall be included:]

[(i) discounts or commissions;]

[(II) reimbursement of expenses to or on behalf of the underwriter and related persons;]

[(iii) fees and expenses of underwriter's counsel (except for reimbursement of "blue sky" fees);]

[(iv) finder's fees, whether in the form of cash, securities or any other item of value;]

[(v) wholesaler's fees;]

[(vi) financial consulting and advisory fees, whether in the form of cash, securities, or any other item of value;]

[(vii) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, received;]

[a. for acting as private placement agent for the issuer;]

[b. for providing or arranging a loan, credit facility, merger or acquisition services, or any other service for the issuer;]

[c. as an investment in a private placement made by the issuer; or]

[d. at the time of the public offering;]

[(viii) sales incentive items;]

[(ix) any right of first refusal provided to any participating member underwriter or participate in future public offerings, private placements or other financings, which will have a compensation value of 1% of the offering proceeds or a dollar amount contractually agreed to by the issuer and underwriter to waive the right of first refusal;]

[(x) compensation to be received by the underwriter and related persons or by any person nominated by the underwriter as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;]

[(xi) commissions, expense reimbursements, previously or other compensation to be received by the underwriter and related persons as a result of the exercise or conversion within twelve months following the effective date of the offering of warrants, options, convertible securities, or similar securities distributed as part of the public offering;]

[(xii) fees of a qualified independent underwriter; and]

[(xiii) compensation, including expense reimbursements, paid to any member in connection with a proposed public offering that was not completed, unless if the member does not participates in the revised public offering.]

[(B) Notwithstanding paragraph (c)(3)(A) above, the following shall not be considered an item of value:]

[(i) expenses customarily borne by an issuer, such as printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; and accountant's fees, whether or not paid through a participating member;]

[(ii) cash compensation for acting as placement agent for a private placement or for providing a loan, credit facility, or for services in connection with a merger/acquisition;]

[(iii) listed securities purchased in public market transactions;]

[(iv) securities acquired through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code;]

[(v) securities acquired by an investment company registered under the Investment Company Act;]

[(vi) nonconvertible or non-exchangeable debt securities acquired for a fair price in the ordinary course of business in a transaction unrelated to the public offering; and] [(vii) derivative instruments entered into for a fair price in the ordinary course of business in a transaction unrelated to the public offering.]

(c)[(d) Determination of Whether Items of Value Are Included In Underwriting Compensation] Securities Acquisitions Not Considered Underwriting Compensation

[(1) Pre-Offering Compensation]

[All items of value received and all arrangements entered into for the future receipt of an item of value by the underwriter and related persons during the period commencing 180 days immediately preceding the required filing date of the registration statement or similar document pursuant to paragraph (b)(4) above until the date of effectiveness or commencement of sales of the public offering will be considered to be underwriting compensation in connection with the public offering.]

[(2) Undisclosed and Post-Offering Compensation]

[All items of value received and all arrangements entered into for the future receipt of an item of value by any participating member that are not disclosed to FINRA prior to the date of effectiveness or commencement of sales of a public offering, including items of value received subsequent to the public offering, are subject to post-offering review to determine whether such items of value are, in fact, underwriting compensation for the public offering.]

[(3) Date of Receipt of Securities]

[Securities of the issuer acquired by the underwriter and related persons will be considered to be received for purposes of paragraphs (d)(1) and (d)(5) as of the date of the:]

[(A) closing of a private placement, if the securities were purchased in or received for arranging a private placement; or]

[(B) execution of a written contract with detailed provisions for the receipt of securities as compensation for a loan, credit facility, or put option; or]

[(C) transfer of beneficial ownership of the securities, if the securities were received as compensation for consulting or advisory services, merger or acquisition services, acting as a finder, or for any other service.]

[(4) Definitions]

[For purposes of paragraph (d)(5) below, the following terms will have the meanings stated below.]

[(A) An entity:]

[(i) includes a group of legal persons that either:]

[a. are contractually obligated to make co-investments and have previously made at least one such investment; or]

[b. have filed a Schedule 13D or 13G with the SEC that identifies the legal persons as members of a group that have agreed to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer in connection with a previous investment; and]

[(ii) may make its investment or loan through a wholly owned subsidiary (except when the entity is a group of legal persons).]

[(B) redesignated as paragraph (i)(10)]

[(C) redesignated as paragraph (i)(2)]

[(D) A right of pre-emption means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to:]

[(i) any option, shareholder agreement, or other contractual right entered into at the time of a purchase of securities;]

[(ii) the terms of the security purchased;]

[(iii) the issuer's charter or by-laws; or]

[(iv) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.]

[(E) redesignated as paragraph (i)(21)]

[(5) Exceptions From Underwriting Compensation]

[Notwithstanding paragraph (d)(1) above, the following items of value] <u>Securities acquired in transactions that meet the requirements of this paragraph (c)</u> are excluded from underwriting compensation <u>and not subject to the lock-up requirements of paragraph (d)(1)</u>, provided that the member does not condition its participation in the public offering on an acquisition of securities [under an exception] <u>in a transaction that</u>

meets the requirements of this paragraph and any securities [purchased]acquired are [purchased]acquired at the same price and with the same terms as the securities purchased by all other investors.

([A]1) Purchases and Loans *by* [by] Certain Affiliates [Entities]—Securities of the issuer purchased in a private placement or received as compensation [for] in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph [(b)(4)](a) [above] by [certain entities] a participating member's affiliate, if:

[(i) each entity:]

[a. either:]

[1. manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;]

[2. manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;]

[3. is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or]

[4. is a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this Rule; and]

(A)[b.] the affiliate is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(B)[c.] [makes] the investments and [or] loans were subject to the evaluation of individuals who have a contractual or fiduciary duty to select investments and loans based on the risks and rewards to the [entity] affiliate and not based on opportunities for the member participating in the offering to earn investment banking revenues;

(C)[d.] the affiliate does not [participate directly in] receive investment banking fees [received by] paid to any participating member for underwriting public offerings; [and]

(D)[e.] the affiliate, directly or through a subsidiary it controls, is [has been] primarily engaged in the business of making investments in or loans to other companies; and

(E) the affiliate either:

i. manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;

ii. manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;

iii. is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or

iv. is a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this Rule.

[(ii) all entities related to each member in acquisitions that qualify for this exception do not acquire more than 25% of the issuer's total equity securities during the review period in paragraph (d)(1), calculated immediately following the transaction.]

(2[B]) Investments *in* [in] and Loans *to* [to] Certain Issuers — Securities of the issuer purchased in a private placement or received as compensation [for] in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph [(b)(4)](a) [above] by [certain entities] a participating member's affiliate if:

(A[i]) the affiliate[each entity]:

(i)[a.] manages capital contributions or commitments of at least $50 million;

(ii)[b.] is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(iii)[c.] does not [participate directly in] receive investment banking fees paid to any participating [received by the] member for underwriting public offerings; and

(iv)[d.] directly or through a subsidiary it controls, is [has been] primarily engaged in the business of making investments in or loans to other companies; [and]

(B[ii]) institutional investors beneficially own at least 33% of the issuer's total equity securities, calculated immediately prior to the transaction; and

(C[iii]) the transaction was approved by a majority of the issuer's board of directors (if the issuer has a board of directors) and a majority of any institutional investors, or the designees of institutional investors, that are board members.[; and]

[(iv) all entities related to each member in acquisitions that qualify for this exception do not acquire more than 25% of the issuer's total equity securities, calculated immediately following the transaction.]

(3[C]) Private Placements with Institutional Investors — Securities of the issuer purchased in, or received as placement agent compensation [for] in connection with, a private placement before the required filing date of the public offering pursuant to paragraph [(b)(4) above] (a) if:

(A[i]) institutional investors purchase at least 51% of the "total offering" (composed [comprised] of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member participating in the offering);

(B[ii]) an institutional investor was the lead negotiator or, if the terms were not negotiated, was the lead investor with the issuer to establish or approve the terms of the private placement; and

(C[iii]) [underwriters and related persons] the participating members did not, in the aggregate, purchase or receive as placement agent compensation more than [2]40% of the "total offering" (excluding purchases by any [entity] affiliate qualified under paragraph [(d)(5)(A) above] (c)(1).

[(D) Acquisitions and Conversions to Prevent Dilution — Securities of the issuer if:]

[(i) the securities were acquired as the result of:]

[a. a right of preemption that was granted in connection with securities that were purchased either:]

[1. in a private placement and the securities are not deemed by FINRA to be underwriting compensation; or]

[2. from a public offering or the public market; or] [b. a stock-split or a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired more than 180 days before the required filing date of the public offering pursuant to paragraph (b)(4) above; or]

[c. the conversion of securities that have not been deemed by FINRA to be underwriting compensation; and]

[(ii) the only terms of the purchased securities that are different from the terms of securities purchased by other investors are pre-existing contractual rights that were granted in connection with a prior purchase;]

[(iii) the opportunity to purchase in a rights offering or pursuant to a right of preemption, or to receive additional securities as the result of a stock-split or conversion was provided to all similarly situated security holders; and]

[(iv) the amount of securities purchased or received did not increase the recipient's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment, except in the case of conversions and passive increases that result from another investor's failure to exercise its own rights.]

[(E) Purchases Based On A Prior Investment History — Purchases of securities of the issuer if:]

[(i) the amount of securities purchased did not increase the purchaser's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and]

[(ii) an initial purchase of securities of the issuer was made at least two years and a second purchase was made more than 180 days before the required filing date of the public offering pursuant to paragraph (b)(4) above.]

[(e) Valuation of Non-Cash Compensation]

[For purposes of determining the value to be assigned to securities received as underwriting compensation, the following criteria and procedures will be applied.]

[(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security]

[An underwriter and related person may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:]

[(A) the security received or the security underlying the warrant or convertible security received is identical to the security offered to the public or to a security with a bona fide independent market; or]

[(B) the security can be accurately valued, as required by paragraph (f)(2)(I) below.]

[(2) Valuation of Securities That Do Not Have an Exercise or Conversion Price]

[Securities that do not have an exercise or conversion price shall have a compensation value based on:]

[(A) the difference between:]

[(i) either the market price per security on the date of acquisition, or, if no bona fide independent market exists for the security, the public offering price per security; and]

[(ii) the per security cost;]

[(B) multiplied by the number of securities received or to be received as underwriting compensation;]

[(C) divided by the offering proceeds; and]

[(D) multiplied by one hundred.]

[(3) Valuation of Securities That Have an Exercise or Conversion Price]

[Options, warrants or convertible securities that have an exercise or conversion price ("warrants") shall have a compensation value based on the following formula:]

[(A) the public offering price per security multiplied by .65;]

[(B) minus the resultant of the exercise or conversion price per warrant less either:]

[(i) the market price per security on the date of acquisition, where a bona fide independent market exists for the security; or]

[(ii) the public offering price per security;]

[(C) divided by two;]

[(D) multiplied by the number of securities underlying the warrants;]

[(E) less the total price paid for the warrants;]

[(F) divided by the offering proceeds; and]

[(G) multiplied by one hundred;]

[(H) provided, however, that, notwithstanding paragraph (e)(4) below, such warrants shall have a compensation value of at least .2% of the offering proceeds for each amount of securities that is up to 1% of the securities being offered to the public (excluding securities subject to an overallotment option).]

[(4) Valuation Discount For Securities With a Longer Resale Restriction]

[A lower value equal to 10% of the calculated value shall be deducted for each 180-day period that the securities or underlying securities are restricted from sale or other disposition beyond the 180-day period of the lock-up restriction required by paragraph (g)(1) below. The transfers permitted during the lock-up restriction by paragraphs (g)(2)(A)(iii) through (iv) are not available for such securities.]

[(5) Valuation of Items of Value Acquired in Connection with a Fair Price Derivative or Debt Transaction]

[Any debt or derivative transaction acquired or entered into at a "fair price" as defined in paragraph (a)(9) and item of value received in or receivable in the settlement, exercise or other terms of such debt or derivative transaction shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the debt or derivative security is not a fair price, compensation will be calculated pursuant to this paragraph (e) or based on the difference between the fair price and the actual price.]

[(g])(d) Lock-Up Restriction on Securities

(1) Lock-Up Restriction

(A) [In any public equity offering, other than a public equity offering by an issuer that can meet the requirements in paragraph (b)(7)(C)(i) or (ii) any common or preferred stock, options, warrants, and other equity securities of the issuer, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered and acquired by an underwriter and related person during 180 days prior to the required filing date, or acquired after the required filing date of the registration statement and deemed to be] Any underwriting compensation consisting of securities [by FINRA, and securities excluded from underwriting compensation pursuant to paragraph (d)(5)(A), (B), (C) and (E) above, shall not be sold during the offering, or] must not be sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities [by any person] for a period of 180 days [immediately following] beginning on the date of [effectiveness or] commencement of sales of the public offering, except as provided in paragraph (d)(2)[(g)(2) below].

(B) The lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (d)(1)[(g)(1) above, the following shall not be prohibited]:

(A) the [transfer of any security] lock-up restriction will not apply if:

(i) the security is required to be transferred by operation of law or by reason of reorganization of the issuer;

(ii[i]) [if] the aggregate amount of securities of the issuer [held] beneficially owned by [the underwriter and related persons] a participating member does not exceed 1% of the securities being offered;

(iii) the securities is of an issuer that meets the registration requirements of SEC Registration Forms S-3, F-3 or F-10; or

(iv) [that] the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that no participating member manages or otherwise directs investments by the fund, and participating members in the aggregate do not own more than 10% of the equity in the fund.[;]

[(v) that is not an item of value under paragraphs (c)(3)(B)(iii) through (vii) above;]

[(vi) that is eligible for the limited filing requirement in paragraph (b)(6)(A)(iv)b. and has not been deemed to be underwriting compensation under the Rule;]

[(vii) that was previously but is no longer subject to the lock-up restriction in paragraph (g)(1) above in connection with a prior public offering (or a lock-up restriction in the predecessor rule), provided that if the prior restricted period has not been completed, the security will continue to be subject to such prior restriction until it is completed; or]

[(viii) that was acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A; or]

(B) the following will not be prohibited:

[(A)(ii)](i) the transfer of any security to any member participating in the offering and its officers or partners, [thereof] its registered persons or affiliates, if all transferred securities [so transferred] remain subject to the lock-up restriction in paragraph (d)(1)[(g)(1) above] for the remainder of the [time] 180-day lock-up period;

(ii) the exercise or conversion of any security, if all securities received remain subject to the lock-up restriction in paragraph (d)(1) [(g)(1) above] for the remainder of the [time] 180-day lock-up period; or

(iii) the transfer or sale of the security back to the issuer in a transaction exempt from registration with the SEC.

[(h)](e) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" as used in this paragraph ([i]e) shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall means any form of compensation received in connection with the distribution of securities that is not cash compensation, including, but not limited to, merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors[1] and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph [(h)(2)](e)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which means an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

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1 The Current annual amount fixed by the Board of Governors is $100.

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph [(h)(2)](e)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph [(h)(2)] (e)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs [(h)(2)] (e)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraphs [(h)(2)](e)(2)(C) through (E).

(f) Unreasonable Terms and Arrangements

[(1) General redesignated as paragraph (a)(1)(A)]

[(2) Prohibited Arrangements]

Without limiting the [foregoing] requirements of paragraph (a)(1)(A), the following terms and arrangements are prohibited[, when proposed in connection with a public offering of securities, shall be unfair and unreasonable.]:

(1) receipt of any underwriting compensation, including in the form of securities, for which a value cannot be determined;

(2[A]) [A]any accountable expense allowance [granted by an issuer to the underwriter and related persons] that includes payment for general overhead, salaries, supplies, or similar expenses [of the underwriter] incurred in the normal conduct of business[.];

[(B) Any non-accountable expense allowance in excess of 3% of offering proceeds.]

(3[C]) [A]any [payment of commissions or reimbursement of expenses directly or indirectly to the underwriter and related persons] underwriting compensation paid prior to the commencement of [the public] sales of the [securities being offered] public offering, except [a reasonable] an advance against [out-of-pocket] accountable expenses actually anticipated to be incurred [by the underwriter and related persons], which [advance is] must be reimbursed to the issuer to the extent not actually incurred[.];

(4[D]) [A]any underwriting compensation [by an issuer to a member or person associated with a member] in connection with a[n] public offering [of securities] that is not completed according to the terms of an agreement [between] entered into by an [the] issuer and [underwriter] a participating member, except:

(A[i]) the reimbursement of [out-of-pocket] accountable[, bona fide] expenses actually incurred by the participating member [or person associated with a member]; and

(B[ii]) a termination fee or a right of first refusal, as set forth in a written agreement [between] entered into by an [the] issuer and [the] a participating member, provided that:

(i)[a.] the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement;

(ii)[b.] an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal;

(iii)[c.] the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv)[d.] the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer.

(5[E]) [A]any right of first refusal [provided to the underwriter or related persons to [underwrite or] participate in the distribution of a future public offering[s], private placement[s] or other financing[s] that:

(A[i]) has a duration of more than three years from the [date of] commencement of sales of the public offering or the termination date of the engagement between the issuer and [underwriter] member; or

(B[ii]) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee[.];

(6[F]) [A]any payment or fee to waive or terminate a right of first refusal [regarding] to participate in a future public offering[s], private placement[s] or other financing[s provided to the underwriter and related persons] that[:]

[(i) has a value in excess of the greater of 1% of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of 1% if additional compensation is available under the compensation guideline of the original offering) or 5% of the underwriting discount or commission paid in connection with the future financing (including any overallotment option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering; or]

[(ii)] is not paid in cash[.];

(7[G]) [The terms or the exercise of the terms of an agreement for] the receipt [by the underwriter and related persons] of underwriting compensation consisting of any option, warrant or convertible security that:

(A[i]) is exercisable or convertible more than five years from the [effective date] commencement of sales of the public offering;

[(ii) is not in compliance with paragraph (e)(1) above;]

(B[iii]) has more than one demand registration right at the issuer's expense;

(C[iv]) has a demand registration right with a duration of more than five years from [the date of effectiveness or] the commencement of sales of the public offering;

(D[v]) has a piggyback registration right with a duration of more than seven years from the [date of effectiveness or the] commencement of sales of the public offering;

(E[vi]) has anti-dilution terms that allow the [underwriter and related persons] participating members to receive more shares or to exercise at a lower price than originally agreed upon at the time of the public offering, when the public shareholders have not been proportionally affected by a stock split, stock dividend, or other similar event; or

(F[vii]) has anti-dilution terms that allow the [underwriter and related persons] participating members to receive or accrue cash dividends prior to the exercise or conversion of the security[.];

[(H) The receipt by the underwriter and related persons of any item of compensation for which a value cannot be determined at the time of the offering.]

(8[I]) [W]when proposed in connection with the distribution of a public offering of securities on a "firm commitment" basis, any overallotment option providing for the overallotment of more than 15% of the amount of securities being offered, computed excluding any securities offered pursuant to the overallotment option[.];

(9[J]) [T]the receipt by a participating member [or person associated with a member, pursuant to an agreement entered into at any time before or after the effective date of a public offering of warrants, options, convertible securities or units containing such securities,] of any compensation [or expense reimbursement] in connection with the exercise or conversion of any [such] warrant, option, or convertible security [in any of the following circumstances] offered in the public offering if:

(A[i]) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

(B[ii]) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion, except where

prior specific written approval for exercise or conversion is received from the customer;

(C[iii]) the compensation arrangements [whereby compensation is to be paid] are not disclosed[:]

[a. in the prospectus or offering circular by which the warrants, options, or convertible securities are offered to the public, if such arrangements are contemplated or any agreement exists as to such arrangements at that time, and]

[b.] in the [prospectus or] offering [circular] documents provided to security holders at the time of exercise or conversion; [or]

(D[iv]) the exercise or conversion [of the warrants, options or convertible securities] is not solicited by the [underwriter or related person] participating members[, provided however, that any request for exercise or conversion will be presumed to be unsolicited unless the customer states in writing that the transaction was solicited and designates in writing the broker-dealer to receive compensation for the exercise or conversion.]; and

(10[K]) [F]for a member to participate with an issuer in the public offering [distribution of a non-underwritten issue] of securities if the issuer hires persons primarily for the purpose of solicitation, marketing, distribution or sales of the offering [distributing or assisting in the distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting], except [to the extent] in compliance with Section 15(a) of the Exchange Act or SEA Rule 3a4-1 and applicable state law.

(g) Exemptions

[(b)(7)](1) Offerings Exempt from Filing

[Notwithstanding the provisions of subparagraph (1) above, d]Documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of Rule 5121(a)(2)[.], provided that the following public offerings must comply with this Rule and, if applicable, Rules 2310 and 5121[. However, it shall be deemed a violation of this Rule or Rule 2310, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or Rule 2310, as applicable]:

(A) securities offered by a [corporate] bank, corporation, foreign government or foreign government agency [issuer which] that has unsecured non-convertible debt with a term of issue of at least four [(4)] years[,] or unsecured non-convertible preferred securities[,] that are investment grade rated [by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories], as defined in Rule 5121(f)(8), or are securities in the same series that have equal rights and obligations as investment grade rated securities, provided [except] that an [the] initial public offering of [the] equity [of an issuer] is required to be filed;

(B) investment grade rated non-convertible debt securities and non-convertible preferred securities [rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories];

(C) offerings of securities[:]

[(i)] registered with the SEC on registration statement Forms S-3, [or] F-3 [pursuant to the standards for those Forms prior to October 21, 1992 and offered pursuant to Rule 415 of SEC Regulation C], or F-10, provided that the registrant is an experienced issuer;

[(ii) of a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory, and is registered with the SEC on Form F-10 pursuant to the standards for that Form approved in Securities Act Release No. 6902 (June 21, 1991) and offered pursuant to Canadian shelf prospectus offering procedures;]

(D) [securities offered pursuant to a redemption standby "firm commitment" underwriting arrangement registered with the SEC on Forms S-3, F-3 or F-10 (only with respect to Canadian issuers);]

[(E)] investment grade rated financing instrument-backed securities [which are rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories];

(E[F]) exchange offers [of securities] where:

(i) the securities to be issued or the securities of the company being acquired are listed on a national securities exchange as defined in Section 6 of the Exchange Act [The Nasdaq Global Market, the New York Stock Exchange, or the American Stock Exchange]; or

(ii) the company issuing securities qualifies to register securities with the SEC on registration statement Forms S-3, F-3, or F-10 and is an experienced issuer [, pursuant to the standards for those Forms as set forth in subparagraph (C)(i) and (ii) of this paragraph];

(F[G]) public offerings of securities by a church or other charitable institution that is exempt from SEC registration pursuant to Section 3(a)(4) of the Securities Act; [and]

(G[H]) offerings of securities issued by a pooled investment vehicle, whether formed as a trust, partnership, corporation, limited liability company or other collective investment vehicle, that is not registered as an investment company under the Investment Company Act and has a class of equity securities listed for trading on a national securities exchange and that[; provided that such equity securities] may be created or redeemed on any business day at their net asset value per share[.]; and

(H) offerings of securities by a "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that is operated as a tender offer fund, provided that the fund:

(i) makes continuous offerings pursuant to Securities Act Rule 415;

(ii) prices its securities monthly;

(iii) limits the total amount of compensation paid to participating members to the amount permitted by the sales charge limitations of Rule 2341, in which case the underwriting compensation provisions of Rule 5110 will not apply;

(iv) makes at least two repurchase offers per calendar year for its securities pursuant to SEA Rule 13e-4 and Schedule TO under the Exchange Act;

(v) does not list its securities on a national securities exchange; and

(vi) files its initial public offering of equity with FINRA.

[(b)(8)](2) [Exempt] Offerings Not Subject to Filing and Rule Compliance

[Notwithstanding the provisions of subparagraph (1) above, the following offerings are exempt from this Rule, Rule 2310, and Rule 5121. Documents and information relating to the following offerings need not be filed for review:]

The following offerings are not subject to this Rule, Rule 2310 and Rule 5121 including not being required to file documents and information for review:

(A) securities exempt from registration with the SEC pursuant to the provisions of Sections 4(a)(1), 4(a)(2) or 4(a)(6) of the Securities Act;

(B) securities exempt from registration with the SEC [or] pursuant to Rule 504 of SEC Regulation D if the securities are "restricted securities" under Securities Act Rule 144(a)(3)[, Rule 505 of SEC Regulation D,] or Rule 506 of Regulation D;

(C) securities exempt from registration with the SEC pursuant to Securities Act Rule 144(A) or SEC Regulation S;

(D[B]) securities which are defined as "exempted securities" in Section 3(a)(12) of the Exchange Act[, as amended];

(E[C]) securities of "open-end" investment companies as defined in Section 5(a)(1) of the Investment Company Act;

(F) [and] securities of any "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that[:]

[(i)] makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act[;] and

[(ii)] offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) of SEC Regulation C;

(G[D]) variable contracts as defined in Rule 2320(b)(2);

(H[E]) modified guaranteed annuity contracts and modified guaranteed life insurance policies, which are deferred annuity contracts or life insurance policies the value of which are guaranteed if held for specified periods, and the nonforfeiture value of which are based upon a market-value adjustment formula for withdrawals made before the end of any specified period;

(I) insurance contracts not otherwise included in paragraph (g)(2)(G) and (H);

(J[F]) [offerings of] municipal securities as defined in Section 3(a)(29) of the Exchange Act;

(K[G]) tender offers made pursuant to SEC Regulation 14D under the Exchange Act;

(L[H]) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act;

(M[I]) securities of a subsidiary or other affiliate distributed by a company in a spin-off or reverse spin-off or similar transaction to its existing security holders exclusively as a dividend or other distribution; [and]

(N[J]) securities registered with the SEC in connection with a merger or acquisition transaction or other similar business combination, except for any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; and [offerings required to be filed pursuant to subparagraph (9)(I) below.]

(O) securities of a unit investment trust as defined in Section 4(2) of the Investment Company Act.

<u>(h)</u>[(i)] <u>Requests for Rule 9600</u> Exemption[s] <u>from Rule 5110</u>

Pursuant to the Rule 9600 Series, [the appropriate] FINRA [staff, for good cause shown after] <u>may in exceptional and unusual circumstances,</u> taking into consideration all relevant factors, <u>exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate</u> [may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest].

[(a)]<u>(i)</u> Definitions

[For purposes of this Rule, the following terms shall have the meanings stated below.] The definitions in Rule 5121 are incorporated herein by reference. <u>For the purposes of this Rule, the following terms have the meanings stated below:</u>

<u>(1) Associated Person</u>

<u>The term "associated person" has the meaning defined in Article I, Section (rr) of the FINRA By-Laws.</u>

[(d)(4)(C)]<u>(2) Bank</u>

[A bank or insurance company is] <u>For the purposes of paragraph (c), the term "bank" refers</u> only <u>to</u> the regulated entity, not its subsidiaries or other affiliates.

[(11)]<u>(3)</u> Company

<u>The term "company" means a</u> [A] corporation, a partnership, an association, a joint stock company, a trust, a fund, or an[y] organized group of persons whether incorporated or not; [or] <u>including</u> any receiver, trustee in

bankruptcy or similar official, or [any] liquidating agent [for] of any of the foregoing[, in his capacity as such].

(4) Compensation

The term "compensation" means cash compensation and non-cash compensation.

[(12)](5) Effective Date

The term "effective date" means t[T]he date on which an issue of securities [first] becomes legally eligible for distribution to the public.

(6) Experienced Issuer

The term "experienced issuer" means an entity that has:

(A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and

(B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

(7) Equity-Linked Securities

The term "equity-linked securities" means any security that are convertible or exchangeable into an equity security.

[(13)](8) Immediate Family

[The parents, mother-in-law, father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or associated person of a member. In addition, the immediate family includes any other person who either lives in the same household as, provides material support to, or receives material support from, an employee or associated person of a member.]

The term "immediate family" means:

(A) the spouse or child of an associated person of a member; and

(B) any relative who either lives in the same household as, has a business relationship with, provides material support to, or receives material support from, an associated person of a member, including, but not limited to, a parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

[(5)(B)](9) Independent Financial Adviser

[For purposes of this provision, an "independent financial adviser" is a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated with any entity that is engaged in, the solicitation or distribution of the offering.]

The term "independent financial adviser" means a member or a person affiliated or associated with a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated or associated with any entity that is engaged in, the solicitation or distribution of the offering.

[(d)(4)(B)](10) Institutional Investor

For the purposes of paragraph (c), the term [An] "institutional investor" [is] means any [individual or legal] person that has an aggregate of at least $50 million invested in securities [in the aggregate] in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members [direct or otherwise] manage the institutional investor's investments or have an equity interest in the institutional investor, either individually or in the aggregate, that exceeds 5% for a publicly owned entity or 1% for a nonpublic entity.

(11) Insurance Company

For the purposes of paragraph (c), the term "insurance company" refers only to the regulated entity, not its subsidiaries or other affiliates.

[(1)](12) Issuer

[The issuer of the securities offered] The term "issuer" means an entity that is offering its securities to the public, registrant, any selling security holder offering securities to the public, any affiliate of the [issuer] entity or selling security holder, and the officers or general partners, and directors[, employees and security holders] thereof.

[(3)](13) Offering Proceeds

[Public offering price] The term "offering proceeds" means the proceeds of all the securities offered [to] in the public offering by participating members, not including securities subject to an[y] overallotment option, securities to be received by the [underwriter and related persons] participating members, or [securities] underlying [other] securities.

(14) Overallotment Option

The term "overallotment option" means an option granted by the issuer to the participating members for the purpose of offering additional shares to the public in connection with the distribution of the public offering.

[(4)](15) Participating Member[(s)]

The term "participating member" means a[A]ny FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any [members of their] immediate family[, and any affiliate of the member].

[(5)](16) Participate, Participation or Participating [in a Public Offering]

The terms "participate," "participation" or "participating" in a public offering means involvement [Participation] in the preparation of the offering document or other documents, [participation] involvement in the distribution of the offering [on an underwritten, non-underwritten, or any other basis], furnishing of customer [and/]or broker lists for solicitation, or [participation in any] providing advisory or consulting [capacity] services to the issuer related to the offering, but not including:

(A) the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEA Rule 13e-3; [or] and

(B) advisory or consulting services provided to the issuer by an independent financial adviser, provided that another member or members are participating in the public offering.

[(14)](17) Person

The term "person" means a[A]ny natural person, partnership, corporation, company, association, or other legal entity.

(18) Public Offering

The term "public offering" means any primary or secondary offering of securities made pursuant to a registration statement, offering circular or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition.

[(10)](19) Required Filing Date

(A) The term "required filing date" [shall be] means the dates [provided] referenced in paragraph (a)(3)[(b)(4),]; and

(B) F[f]or a public offering exempt from filing under paragraph [(b)(7)](g), the term "required filing date" [for purposes of paragraphs (d) and (g) shall be] means the date the public offering would have been required to be filed with FINRA but for the exemption.

(20) Review Period

The term "review period" means:

(A) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering;

(B) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and

(C) for a firm commitment or best efforts takedown or any other continuous offering on behalf of selling securityholders made pursuant to Securities Act Rule 415, the 180-day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.

[(d)(4)(E)](21) Total Equity Securities

For the purposes of paragraph (c), the term "[T]total equity securities" means the aggregate of the total shares of:

(A[i]) common stock outstanding of the issuer; and

(B[ii]) common stock of the issuer underlying all convertible securities outstanding that convert without the payment of any additional consideration.

(22) Underwriting Compensation

The term "underwriting compensation" means 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. In addition, underwriting compensation shall include finder fees, and underwriter's counsel fees, including expense reimbursements and securities.

• • • Supplementary Material: --------------

.01 Underwriting Compensation.

(a) The following are examples of payments or benefits that are considered underwriting compensation:

(1) discounts or commissions;

(2) fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses;

(3) fees and expenses of counsel to participating members (except for reimbursement of "blue sky" fees);

(4) finder fees;

(5) wholesaling fees and expenses;

(6) financial consulting and advisory fees;

(7) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, beneficially owned, as defined in Rule 5121 by the participating members the value of which is determined pursuant to this Rule, and acquired during the review period, as defined in this Rule;

(8) sales incentive items;

(9) any right or rights of first refusal provided to any participating member to participate in future public offerings, private placements or other financings, the value of which will be 1% of the offering proceeds or a dollar amount contractually agreed to by the issuer and the participating member to waive the right of first refusal;

(10) compensation to be received by a participating member or by any person nominated by the participating member as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;

(11) any compensation to be received by the participating members as a result of the exercise or conversion of warrants, options, convertible securities, or similar securities distributed as part of the public offering within 12 months following the commencement of sales;

(12) fees of a qualified independent underwriter required by Rule 5121;

(13) any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering; and

(14) non-cash compensation, such as gifts, training and education expenses, sale incentives, and business entertainment expenses.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; fees of independent financial advisers; and accountant's fees, and other fees and expenses customarily borne by an issuer, whether or not paid by or through a participating member;

(2) cash compensation for acting as placement agent for a private placement or for providing or arranging for a loan, credit facility, or for services in connection with a merger or acquisition;

(3) records management and advisory fees and expenses in connection with the conversion of the issuer from a mutual holding company to a stock holding company;

(4) payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer;

(5) compensation for providing brokerage, trust and insurance services to the issuer that is received in the ordinary course of business;

(6) fees for commercial banking services, which does not require registration as a broker-dealer, provided to the issuer in the ordinary course of business;

(7) compensation for providing services in a prior or concurrent public offering separately filed or exempt from filing pursuant to this Rule;

(8) a right of first refusal that is provided to a participating member in connection with a prior financing if the right of first refusal does not extend beyond the initial closing of the public offering currently under review or if the right of first refusal has already been included as underwriting compensation in a prior or concurrent public offering;

(9) dividends paid to shareholders of a class of the issuer's securities when participating members are shareholders of that class;

(10) securities of the issuer pledged as collateral for a bona fide loan;

(11) listed securities purchased in public market transactions;

(12) compensation received through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code or a similar plan;

(13) securities acquired by an investment company registered under the Investment Company Act;

(14) securities acquired as the result of a conversion of securities that were originally acquired prior to the review period;

(15) securities acquired as the result of an exercise of options or warrants that were originally acquired prior to the review period;

(16) securities acquired as the result of a stock-split, a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired prior to the review period;

(17) securities acquired as the result of a right of preemption that was granted prior to the review period;

(18) securities acquired in order to prevent dilution of a long-standing interest in the issuer, if:

(A) the amount of securities does not increase a member's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and

(B) an initial purchase of securities of the issuer was made at least two years preceding the required filing date and a second purchase was made before the review period.

(19) non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) securities acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A; and

(21) securities acquired in the secondary market by a participating member that is a broker-dealer in connection with the performance of bona fide customer facilitation activities; provided that securities acquired from the issuer will be considered "underwriting compensation" if the securities were not acquired at a fair price (taking into account, among other things customary commissions, mark-downs and other charges).

(c) Definitions.

(1) The term "listed securities" means securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S.

(2) The term "right of pre-emption" means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to: (A) any option, shareholder agreement, or other contractual right entered into at the time of purchase of

securities; (B) the terms of the securities purchased; (C) the issuer's charter or by-laws; or (D) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.

.02 Valuation of Underwriting Compensation.

The value of non-convertible securities received as underwriting compensation will have a compensation value based on the difference between (i) the public offering price per security; and (ii) the per security cost.

The value of options, warrants and other convertible securities received as underwriting compensation must 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. Consideration paid by the participating member to acquire such securities will be taken into account and credited against the value as so calculated.

If a participating member wishes to reduce the proposed maximum value of any securities received as underwriting compensation, they may do so by voluntarily agreeing to lock-up such securities for successive 180-day periods (in addition to the initial lock-up period required by paragraph (d) of this Rule if applicable). Each additional 180-day period will reduce the proposed maximum value attributable to such securities by 10%.

.03 Disclosure of Underwriting Compensation. A description of each item of underwriting compensation received or to be received by a participating member, including the maximum aggregate amount of all underwriting compensation, must be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document). The description need not include the dollar amount ascribed to each individual item of compensation (other than the underwriting discounts or commissions). When securities are acquired by a participating member, material terms and arrangements of the acquisition must also be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document) when applicable, such as exercise terms, demand and piggyback registration rights and lock-up periods that may apply. Similarly, if underwriting compensation consists of a right of first refusal to participate in the distribution of a future public offering, private placement or other financing, the description should reference the existence of such right and its duration. The 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.

.04 Non-Convertible or Non-Exchangeable Debt Securities and Derivatives.

(a) Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation value. Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule and members must provide a description of the methodology used to value the security as required by paragraph (a)(4)(B)(iii) of this Rule.

(b) The term “derivative instrument” means any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term “fair price” means the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm’s length, commercially reasonable basis, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services, is not included within this fair price definition.

* * * * *

5121. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraphs (1) or (2).

(1) There must be prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering, and one of the following conditions must be met:

(A) the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(11[2])(E);

(B) through (C) No Change.

(2) No Change.

(b) through (e) No Change.

(f) Definitions

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

(1) through (10) No Change.

(11) [Public Offering]

[The term "public offering" means any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition and all other securities offerings of any kind whatsoever, except any offering made pursuant to:]

[(A) an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act;]

[(B) Securities Act Rule 504, if the securities are "restricted securities" under Securities Act Rule 144(a)(3), Securities Act Rules 505 or 506; or]

[(C) Securities Act Rule 144A or SEC Regulation S.]

[The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Exchange Act.]

(11[2]) Qualified Independent Underwriter

The term "qualified independent underwriter" means a member:

(A) that does not have a conflict of interest and is not an affiliate of any member that has a conflict of interest;

(B) that does not beneficially own as of the date of the member's participation in the public offering, more than 5% of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days;

(C) that has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act, specifically including those inherent in Section 11 thereof; and

(D) that has served as underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering without a registration statement. This requirement will be deemed satisfied if, during the past three years, the member:

(i) with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering; and

(ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering.

(E) none of whose associated persons in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) has been convicted within ten years prior to the filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;

(ii) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or

(iii) has been suspended or barred from association with any member by an order or decision of the SEC, any state, FINRA or any other self-regulatory organization within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.

(12[3]) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act; notification on Form 1A filed with the SEC pursuant to the provisions of Securities Act Rule 252; or any other document, by whatever name known, initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any federal or state agency.

(13[4]) Subordinated Debt

The term "subordinated debt" includes (A) debt of an issuer which is expressly subordinate in right of payment to, or with a claim on assets subordinate to, any existing or future debt of such issuer; or (B) all debt that is specified as subordinated at the time of issuance. Subordinated debt shall not include short-term debt with maturity at issuance of less than one year and secured debt and bank debt not specified as subordinated debt at the time of issuance.

* * * * *

Exhibit 2b

List of Written Comments
Regulatory Notice 17-15

1. W. Hardy Callcott, ("Callcott") (May 30, 2017)

2. Sullivan & Cromwell LLP, Sullivan & Cromwell LLP ("Sullivan") (June 13, 2017)

3. Sean Davy, Securities Industry and Financial Markets Association ("SIFMA") (June 1, 2017)

4. John H. Grady, Alternative & Direct Investment Securities Association ("ADISA") (July 14, 2017)

5. Ellenoff Grossman & Schole LLP, Ellenoff Grossman & Schole LLP ("EGS") (July 14, 2017)

6. Susan Krawczyk and Clifford Kirsch, Committee of Annuity Insurers ("CAI") (July 7, 2017)

7. David M. Lynn, American Bar Association ("ABA") (July 13, 2017)

8. Davis Polk & Wardwell LLP, Davis Polk & Wardwell LLP ("Davis Polk") (July 14, 2017)

9. Mike Rothman, North American Securities Administrators Association, Inc. ("NASAA") (July 14, 2017)

10. Suzanne Rothwell, Rothwell Consulting LLC ("Rothwell") (June 27, 2017)

11. C. Allan Swaringen and Jon E. Abrahamovich, Jones Lang LaSalle Income Property Trust, Inc. and LaSalle Investment Management Distributors, LLC ("JLL") (July 14, 2017)

Jennifer Piorko Mitchell
Office of the Secretary
FINRA
1735 K St. NW
Washington, DC 20006

Re: Regulatory Notice 17-15, Corporate Financing: Proposed Changes to FINRA Rule 5110

To the FINRA Leadership Team:

I have been a securities lawyer representing broker-dealers and others in the financial services markets for 30 years. I am a former Assistant General Counsel at the SEC, a former General Counsel at a large national broker-dealer, and a former Chair of the ABA Business Law Section Subcommittee on Trading and Markets and of the SEC Historical Society. I write this letter solely on my own behalf, and not on behalf of my law firm or any clients.

I write this letter to encourage FINRA to think more broadly about the reform of FINRA Rule 5110. In my view, FINRA Rule 5110 should be converted into a disclosure-only rule, requiring full disclosure of the financial relationships between a broker-dealer and its client in any securities underwriting, but not imposing substantive restrictions on the compensation received in those relationships.

I accept that Rule 5110 was created with the best of intentions – to prevent underwriters from imposing unconscionable pricing terms on potentially vulnerable corporate clients. However, I believe the rule as currently written has done more harm than good, and would continue to do so under the amendments proposed (again, I stipulate that these amendments were proposed with good intentions) by FINRA.

FINRA Rule 5110 is a price-fixing rule, which sets the maximum compensation a broker-dealer may earn in an underwriting. Absent the approval of the SEC, the price-fixing components of Rule 5110 would be a per se violation of the federal antitrust laws (SEC approval of course creates antitrust immunity for FINRA). More than 50 years of antitrust scholarship demonstrates conclusively that fixed prices – even fixed maximum prices – almost invariably harm consumer welfare. I urge FINRA to direct its Office of the Chief Economist to perform a full analysis of the price-fixing elements of Rule 5110 and consider the alternative of a disclosure-only rule. There is only one possible conclusion such an analysis could reach.

In practice, FINRA Rule 5110 is a textbook example of why even maximum price-fixing regulations, in the end, do not benefit the public. FINRA Rule 5110 has become increasingly more complex and hard to apply, as public companies and underwriters find new ways to reach economically efficient arrangements despite the existence of the rule. As a result, FINRA must continually amend the rule to forbid new and creative means of compensation. Over time, the rule has become ever more complex, expensive and difficult to apply. This set of proposed amendments recognizes that the Rule has by now become fully Byzantine in its complexity – but in my view incremental simplification (as proposed here) is not the answer.

The underlying issue is that there will always be small, troubled public companies which have a desperate need for financing, and are willing to pay substantial compensation to obtain that financing. These troubled public companies present the highest liability risk for underwriters, and underwriters are unwilling to assist them unless they are adequately compensated for that risk.[1] And that is exactly what has happened – underwriters will not touch small, troubled public companies. But limiting the compensation that broker-dealers can receive does not remove the problems that these small, troubled public companies face. Rather, because of FINRA Rule 5110, those companies end up being shut out entirely from assistance from broker-dealers. There are a variety of funding providers (many of them hedge funds), some of which are much more unscrupulous than others, which are willing to finance these companies. Some of these providers offer financing vehicles, such as "death spiral" or "toxic" debt or preferred stock offerings, which can have very serious negative consequences for the companies and their investors. In the absence of a broker-dealer to help companies navigate this complex and non-transparent landscape of potential financers, many companies end up choosing financing options that are highly sub-optimal. As a result, many of these companies end up with financing options much worse than they could have obtained with the assistance of a sophisticated broker-dealer experienced in this market. FINRA Rule 5110 does not solve the problem of small troubled companies in need of financing – it simply moves that problem to a largely non-transparent and unregulated environment, to the significant detriment of the companies and their investors.

Moreover, the complexity of FINRA Rule 5110 imposes substantial costs on all underwritings, not just those for the small, troubled companies the rule was designed to protect. The complexity of Rule 5110 has resulted in the development of a small bar of law firm outside counsel who can follow the complexities of the rule – many of these complexities not contained in the rule itself, but in interpretive letters or only learned through the processing of individual applications. The ABA Business Law Section has a subcommittee devoted exclusively to this topic (itself a sign that the rule has metastasized well beyond its original intent). The need to consult this small and highly-compensated coterie of experts on every transaction, just to fill out FINRA's forms correctly and obtain prompt approval of the transaction, creates expense and delay for every transaction, even for those for which there is no substantive concern about the compensation at issue. This approval process is in effect a tax on every underwritten transaction – and serves as a substantial incentive instead to conduct private placements or other transactions without an underwriter directly with a hedge fund that are outside of the scope of the rule.

Twenty years ago the NASD abandoned its excess spread rule for market-makers – also a rule originally created with good intentions but which in practice proved to have an adverse impact on the markets. FINRA Rule 5110 is this generation's excess spread rule – a rule adopted with good intentions but that has outlived whatever use it may have once have had. FINRA has every reason to require full disclosure of the economic relationships between underwriters and public companies, and I support full disclosure of those relationships. But it has proven counter-productive for FINRA to try to regulate the substantive levels of compensation in transactions

[1] The executive management of small public companies is less in need of substantive protections than, for example, the primarily retail investors protected by the mark-up/mark-down limits in FINRA Rule 2121.

between underwriters and their corporate clients. I urge FINRA to rethink Rule 5110 from the ground up, and consider whether a disclosure-only version of the rule would better support capital formation without any unnecessary harm to customer protection. In particular, I believe a full analysis by the Office of the Chief Economist would confirm that the substantive price-fixing in Rule 5110 harms overall public welfare. The SEC in the new administration is attempting to encourage small business capital formation, to make it easier for small companies to go public, and to make it simpler for those small companies to raise capital after they have become public. A disclosure-only version of FINRA Rule 5110 would make it quicker, cheaper and easier for small public companies to raise capital, and in the end this result not only would help broker-dealers, but also would benefit public companies and their investors.

Sincerely,

W. Hardy Callcott

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June 13, 2017

Via E-mail

Jennifer Piorko Mitchell,
Office of the Corporate Secretary,
FINRA,
1735 K Street, NW,
Washington, DC 20006-1506.
(pubcom@finra.org)

Re: Regulatory Notices 17-14 and 17-15

Dear Ms. Mitchell:

We are pleased to submit this letter in response to FINRA's request for comment relating to FINRA rules affecting capital formation. We appreciate FINRA's efforts to engage in continued review of its rules in response to changes in the capital markets and its willingness to consider the effectiveness and efficiency of its existing rules in practice. In particular, we believe that FINRA should reconsider the application of its rules in light of the now well-seasoned regulatory regime applicable to well-known seasoned issuers ("WKSIs")[1] and other issuers eligible to file on Forms S-3 and F-3.

Rule 5110 – Corporate Financing Rule – Underwriting Terms and Arrangements

FINRA Rule 5110 prohibits unfair and unreasonable underwriting arrangements in connection with the public offering of securities. The Rule was adopted in 1992 in response to "persistent problems with underwriters dealing unfairly with

[1] In this letter we use the term "well-known seasoned issuer" as defined in Rule 405 under the Securities Act of 1933.

issuers" and requires members participating in a public offering to file information with FINRA about the underwriting terms and arrangements. FINRA's Corporate Financing Department reviews this information before the commencement of the offering to ensure member firm compliance with requirements of Rules 5110 and 5121.

FINRA Should Exempt Offering of Securities Registered on Forms S-3 and F-3 Entirely from the Requirements of Rule 5110.

In Regulatory Notice 17-15, FINRA has requested comments on a modernization of Rule 5110, which seeks to improve the administration of the Rule and simplify its application. We appreciate these efforts and believe the proposed amendments facilitate these goals. However, we believe FINRA should consider exempting all offerings of securities registered on Forms S-3 and F-3 entirely from the Rule – both the substantive and filing requirements. At a minimum, we believe that FINRA should revise its "experienced issuer" definition to conform to existing Forms S-3 and F-3.[2] The SEC's securities offering reform is now over a decade old and, in our view, offering practices by issuers eligible to file on Forms S-3 and F-3 are

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2 FINRA is proposing to amend the rule to delete specific reference to the "1992 standards" and instead exempt offerings of securities registered with the SEC on registration statement Forms S-3, F-3, or F-10, provided that the registrant is an "experienced issuer". The term "experienced issuer" means an entity that has (A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and (B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

We note that this proposed definition has no direct counterpart to any existing SEC rule and serves to combine several concepts into one rule -- old Form S-3 eligibility requirements and a Regulation M actively-traded concept. We perceive no reason for FINRA to create its own definition to identify seasoned issuers and would recommend as discussed above that, at a minimum, FINRA define "experienced issuer" by reference to existing SEC rules.

well-established. Rule 5110 impedes the access to the capital markets that we believe the SEC anticipated in adopting the reforms and there simply is no justification for creating a "speed bump" to Form S-3/F-3 eligible issuers' accessing the capital markets.

In light of the now well-established market practices with Form S-3/F-3 eligible issuers, we believe that these issuers do not need FINRA's protection in the negotiation of underwriting terms and arrangements. These issuers have been subject to the reporting requirements of Sections 12 and 15(d) of the Securities Exchange Act of 1934 for at least 12 months and are generally closely followed by the investing public and by market professionals. We believe that market forces are sufficient to ensure fair and reasonable underwriting terms and arrangements for this category of issuers and that FINRA's oversight in this regard creates an unnecessary speed bump to these issuers' accessing the capital markets. Nor do we see how requiring an additional 24 months of reporting history enhances the ability of these issuers to fend for themselves, particularly in the case of WKSIs; in our view, this aspect of the "experienced issuer" definition has no rational basis.

In addition, the continued application of Rule 5110's filing requirements to offerings of securities registered on Forms S-3 and F-3 is no longer serving any useful purpose. The Form S-3/F-3 shelf base prospectus is often submitted to FINRA by the issuer at a time when FINRA member firms have not been identified to participate in an offering from the shelf, underwriting terms and arrangements have not been agreed upon, and, indeed, a specific offering may not even have been contemplated. At that time, FINRA issues a no-objections letter immediately upon payment of the filing fee (which, for a WKSI shelf, is $225,500). In respect of shelf take down offerings, FINRA likewise issues immediate clearance and, in the case of takedowns from a WKSI shelf, does not require that any filing at all be made under Rule 5110. Since at the time the shelf base prospectus is submitted there are no underwriting terms or arrangements for FINRA to review, FINRA is simply in no position to ensure that participating member firms are complying with Rule 5110's substantive requirements. And when underwriting terms and arrangements have been agreed upon with respect to a takedown from the shelf, FINRA is not reviewing the information submitted relating to those terms and arrangements (and not requiring submission of such information for WKSIs). For these reasons, we recommend that offerings of securities registered on Forms S-3 and F-3 be exempt from all of the Rule's requirements. At a minimum, we believe WKSIs should be exempt entirely from the Rule.

We also believe that all offerings of investment grade debt, preferred stock and other fixed-income securities should likewise be exempt from Rule 5110 altogether. In our experience, these offerings involve the tightest underwriting spreads and are intensely negotiated by issuers. There is, again, simply no need in this market for Rule 5110 to act as a speed bump to an offering.

FINRA Should Exempt from all Conduct Rules Offerings by S-3 and F-3 Eligible Issuers and Investment-Grade Debt, Preferred Stock and Other Fixed-Income Securities

We would also ask FINRA to exempt offerings by S-3/F-3 eligible issuers and offerings of investment-grade debt, preferred stock and other fixed-income securities from all "Conduct Rules" and to treat these offerings in the same manner as offerings conducted pursuant to Rule 144A. In our view, application of the FINRA Conduct Rules to these offerings creates incentives to utilize Rule 144A and other exemptions from SEC registration. We do not believe that this is preferable from a capital markets or regulatory perspective. Once again, market practices with these types of issuers/offerings are well-developed and application of the FINRA Conduct Rules, in our view, creates unnecessary speed bumps. This is especially true under FINRA Rule 5121 where a "conflict of interest" often arises just from a debt repayment to an affiliate of a member firm.

In any event, we believe that, at a minimum, the requirement for a qualified independent underwriter in Rule 5121 should not apply to any offerings by Form S-3/F-3 eligible issuers.

Rule 5130 – Restrictions on the Purchase and Sale of Initial Equity Public Offerings ("New Issue Rule")

FINRA implemented the New Issue Rule to protect the integrity of the public offering process. The Rule is designed to ensure that member firms participating in the offering make bona fide public offerings of securities at the offering price, and do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to a member, and to ensure that industry insiders (that is, members and their associated persons), do not take advantage of their "insider" status to gain access to new issues for their own benefit at the expense of the public customer. We believe that the Rule, as a general matter, has been effective in this regard, but believe that the reach of "restricted person" status is too broad and the de minimis exemption has not been effective in permitting non-restricted persons to participate in public offerings, particularly when such participation is via a collective investment account. We believe that FINRA could address this unintended consequence in either of two ways: raise the threshold within the de minimis exemption to 25 percent, which is the current threshold in the de minimis exemption in Rule 5131, or revise the definition of "restricted person" to exclude administrative personnel and non-investment banking personnel and to exclude entirely member firms not participating in the offering.

The De Minimis Exemption is Not Operating to Allow Non-Restricted Persons in Collective Investment Vehicles to Participate in Public Offerings

When FINRA adopted the New Issue Rule, it included an exemption from the Rule's prohibition that permits a FINRA member firm to sell new issue to an account if the interests of restricted persons do not exceed 10 percent in the aggregate. In creating the de minimis exemption, FINRA noted that allocations to accounts that are owned 90 percent or more by non-restricted persons generally do not present concerns underlying the Rule, and while it is true that restricted persons may receive some benefit from new issue, nearly all of the benefit flows to non-restricted persons. FINRA expressly permits the "carving out" of the interests of restricted persons in a collective investment vehicle so that the non-restricted co-investors can participate in the new issue even when the account may be beneficially owned in excess of 10 percent by restricted persons. Our experience, however, is that collective investment vehicles are unwilling to engage in the administrative burden of carving out the interests of restricted persons and are, as a result, denying participation in new issue offerings altogether to collective investment vehicles in which restricted persons own more than 10 percent.

We believe that FINRA could increase the de minimis threshold to 25 percent, as is currently the case in Rule 5131, without jeopardizing the concerns the Rule is attempting to address. Such an increase would permit more public investors to participate in initial public offerings, which participation is largely through collective investment vehicles as a practical matter. Aligning the de minimis threshold in Rule 5130 to that in Rule 5131 would also ease the burden of compliance in the situation where a collective investment vehicle has investors that are Rule 5130 restricted persons and investors that are Rule 5131 covered persons, which we have observed is not uncommon. Under the current construct, a collective investment vehicle that has investors that are associated persons of a FINRA member firm, and also has investors who are executive officers or directors of a covered non-public company, would need to take the lower threshold. There does not seem to be any practical reason to impose different thresholds in the two rules.

The Definition of Restricted Person Should be Narrowed

We also believe that the definition of "restricted person" should be amended to exclude individuals who are associated with, or employed by, broker-dealers but who are administrative personnel or non-investment banking personnel. Currently, the definition includes "persons associated with a member firm", which includes many individuals who have no decision-making authority, and also includes all employees of a broker-dealer, including those in purely administrative roles, as well as their immediate family members who receive material support from, or provide material support to, the employee. Including administrative personnel and members of their immediate family is simply unnecessary, in our view. We suggest that the Rule be limited to the situations where its concern is the greatest – investment banking personnel. Investment banking personnel are those who may have a decision-making role in allocating securities in an offering. Administrative personnel and personnel not involved in the investment banking business (and their immediate family members) are, in fact, very similar to members of the "public" the Rule is designed to protect.

At the very least, we would ask FINRA to consider limiting "restricted person" status in respect of broker-dealer personnel to personnel of those broker-dealers that are participating in the subject public offering. Personnel of member firms not participating in the offering are more fairly viewed as part of the "public", in respect of that offering. Encompassing employees of these firms (and their immediate family members) within the Rule is clearly overbroad.

FINRA Should Clarify that Offerings Conducted under Regulation S are not "New Issues" under the Rule

We would also ask FINRA to clarify that public offerings conducted under Regulation S, which occur outside the United States, fall outside the definition of "New Issue" in Rule 5130. It may well be that, as a practical matter, FINRA member firms do not participate in offerings conducted under Regulation S. We believe, though, that the Rule would benefit from clarity on this point and would be most helpful to FINRA member firms that have associated persons dual-hatted with a non-US affiliated broker-dealer.

* * *

Once again, we appreciate the opportunity to submit these comments. If you have any questions, please contact Robert Buckholz at 212-558-3876, Robert Reeder at 212-558-3755, or David Harms at 212-558-3882.

Sincerely,

Sullivan & Cromwell LLP

Sullivan & Cromwell LLP

sifma
Invested in America

June 1, 2017

Submitted via email to: pubcom@finra.org

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

Re: FINRA Regulatory Notice 17-15
Request for Comment on Proposed Amendments
to FINRA's Corporate Financing Rule

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter in response to the request for comment by the Financial Industry Regulatory Authority, Inc. ("FINRA")[2] set forth in Regulatory Notice 17-15 issued April 12, 2017 ("RN 17-15")[3] with respect to proposed amendments to FINRA's Corporate Financing Rule ("Rule 5110" or the "Rule").

SIFMA supports FINRA's efforts to review, streamline and modernize its rules and believes the proposed amendments to Rule 5110 are an important step in that process. Rule 5110 impacts nearly every U.S. public offering and thus greatly affects the capital formation process. As a result, it is critical that FINRA weigh its investor protection mandate and market oversight role against the imposition on market participants of burdensome regulations that unnecessarily impede an issuer's capital raising efforts or force companies to turn to private sources of funding to grow their businesses and meet their liquidity needs.

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] For purposes of this submission, references to FINRA are deemed to include its predecessor, the National Association of Securities Dealers, Inc. ("NASD").

[3] References herein to RN 17-15 include Attachment A thereto, which sets forth Rule 5110 as it is proposed to be amended (the "Proposed Rule"). Attachment A was revised on May 24, 2017 to make a modification to subsection (g) of the Proposed Rule.

Rule 5110 (like its predecessor rule, NASD Rule 2710) appears to have been constructed based on a fundamental underlying assumption that we believe should be reconsidered in light of current capital markets realities. The assumption is that, without FINRA intervention, issuers are not able to protect themselves from unscrupulous underwriters seeking to coerce them into unfair compensation arrangements. FINRA's skepticism about the motivations of FINRA member firms when engaging in public offerings apparently led to the last large-scale rewrite of NASD Rule 2710 in 2004 (the "2004 Rule Change"), when the Rule was transformed from a more principles-based approach (which included a number of factors that would be considered in assessing underwriting compensation) to an extremely prescriptive approach in which all items of value received by participating members within the review period are (subject to very limited and narrow exceptions) deemed to be underwriting compensation.[4] This change in the fundamental structure of the Rule was purportedly intended to simplify FINRA's review process by making the standard for inclusion as underwriting compensation more "objective."[5]

However, we believe this overly prescriptive approach, together with the sweeping presumption that all items of value received during the review period by a FINRA member, its affiliates and associated persons are underwriting compensation – which effectively captures many types of arrangements that were entered into for independent, legitimate reasons having nothing to do with the provision of underwriting services in connection with the public offering – is unnecessary and places a significant burden on the capital formation process. In particular, the uncertainty around whether a purchase of a potential issuer's securities would be counted as underwriting compensation deprives issuers of a source of funding and security holders a source of liquidity, and may make potential underwriters or their affiliates less inclined to make an investment in an issuer for fear of being unable to participate in future underwriting transactions.

Issuers in public offerings are uniformly represented by counsel and frequently engage sophisticated independent financial advisors or have private equity fund shareholders, who play a significant role in the offering process and in negotiating underwriting compensation. Moreover, FINRA can quite adequately address any concerns regarding isolated instances of unfair dealing with issuers or the proposal of unreasonable underwriting terms or arrangements by particular member firms through enforcement under existing FINRA Rule 2010, which requires member firms to adhere to business conduct standards that are just and equitable. Accordingly, we believe Rule 5110 should be retooled to more appropriately focus on disclosure to the investing public of the proposed underwriting terms and arrangements. Such a change, which effectively would

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[4] *See* SR-NASD-2000-004; *see also* NASD Notice to Members 04-13 (February 2004) ("NTM 04-13"), which discussed the rationale for the proposed amendments to Rule 2710 that were approved by the Securities and Exchange Commission (the "SEC") on December 23, 2003 and became effective on March 22, 2004.

[5] See NTM 04-13 at p. 114.

shift back to a more principles-based approach where member firms are required to disclose the terms and arrangements relevant to assessing the reasonableness of underwriting compensation levels based on established guiding principles, would substantially improve the capital formation process by reducing costs and increasing certainty with respect to syndicate composition and transaction timeframes.

While we thus strongly encourage FINRA to consider a more disclosure-focused and principles-based approach to Rule 5110 as part of its retrospective review of the efficacy of its capital formation rules,[6] we believe the proposed amendments to Rule 5110, which do come closer to striking a more appropriate balance between protecting issuers and reducing overall transaction costs through the elimination of unnecessarily burdensome regulation, can serve as a useful interim step in that process and we appreciate the opportunity to provide our thoughts with respect to the Proposed Rule.

Rule 5110 has often been accused of being overly complex and confusing, particularly given that the key terms used in the Rule (including "issuer," "underwriter and related person" and "item of value") are excessively broad. As a result, member firms and their counsel have been forced to seek interpretive guidance or exceptions from the Rule from FINRA staff for terms or arrangements that appear to fall within the literal words of the Rule's provisions, but which do not raise the concerns the Rule was attempting to address. By reorganizing the Rule and adding the Supplementary Material, we believe the Rule will be easier to understand and navigate, and the instances in which additional guidance or relief must be sought will be reduced.[7] Accordingly, we are in favor of the structural approach to the Rule laid out in RN 17-15. We also strongly support the general principals reflected in the Proposed Rule that (1) any benefit received by a participating member be deemed underwriting compensation only if it is received for underwriting, allocation, distribution, advisory or other investment banking services provided in connection with the public offering and (2) any securities received by a participating member not deemed to be underwriting compensation under the Rule are not subject to the Rule's lock-up provisions. Our comments below are intended to strengthen and clarify these overriding principles and we believe these changes will lessen the burdens placed on capital formation under the current Rule by providing greater certainty and reducing the need to request exemptive relief.

Our comments follow the sequencing of the Proposed Rule and are not otherwise prioritized in terms of relative importance. Of course, we believe that all the comments are valid and will help make the Proposed Rule more understandable and workable, leading to greater overall compliance and consistency.

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[6] With respect to our comments more generally on the capital formation process, see SIFMA's submission in response to FINRA Regulatory Notice 17-14 (the "SIFMA Capital Formation Letter").

[7] The inclusion of the substantive, extensive Supplementary Materials is also particularly helpful (as were the guiding factors that were effectively removed with the change to the more prescriptive approach in 2004) to participating members with respect to public offerings that, though subject to rule compliance, are not required to be filed with FINRA.

1. <u>The Notification and Filing Requirements for Public Offerings Should be Further Narrowed and Clarified (Proposed Rule 5110(a))</u>

A. Paragraph (a)(1)(B) of the Proposed Rule requires that the managing underwriter notify the other members if "the underwriting terms and arrangements are unfair and unreasonable" and not "appropriately modified." We believe this requirement should be clarified to require notification be made by the managing underwriter only if FINRA has made such determination with respect to the terms and arrangements of an offering and has so notified the managing underwriter. In this regard, we note that underwriters' counsel may file with FINRA certain information with respect to a participating underwriter that is confidential and not shared with the other members of the syndicate, including the managing underwriter. Moreover, if an offering is not required to be filed, the managing underwriter may not be aware if another underwriter has entered into an arrangement that is "unfair and unreasonable" within the meaning of the Rule. In the latter instance, the requirement set forth in Rule 5110(a)(1)(A) should suffice and the managing underwriter should not be placed at risk for information it had no reason to know.

B. Paragraph (a)(3)(A) of the Proposed Rule extends the period within which documents must be filed with FINRA from one business day to three business days after the applicable triggering event. We support this change and agree that it should help reduce the number of late filings due to logistical issues or inadvertent delays without impeding FINRA's ability to review the underwriting terms and arrangements for filed offerings.

C. Paragraph (a)(4)(A)(iii) of the Proposed Rule provides that "if amendments to any documents previously filed contain changes to the offering and the underwriting terms and arrangements for a public offering, marked pages showing the changes to such document" be filed. We believe FINRA intended this provision to alleviate some of the burden placed on member firms under Rule 5110, which currently requires the filing of all amendments, and we welcome such modification. However, the reference to "changes to the offering" may be read so broadly as to eviscerate the intended limitation. Accordingly, we request that FINRA modify this provision such that amendments to previously filed documents (with pages marked to show changes) would only be required to be filed if they contain "changes to the underwriting terms and arrangements" for the public offering.

D. Paragraph (a)(4)(B)(iv) of the Proposed Rule limits the required representation as to the association or affiliation between participating members and beneficial owners of 5% or more of <u>*any*</u> class of the issuer's securities by referring instead to those beneficially owning 5% or more of any class of the issuer's <u>*equity or equity-linked securities*</u>. In addition, the Proposed Rule eliminates the requirement in the current Rule to provide a representation as to the association or affiliation between participating members and "any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering." SIFMA supports these changes and believes that the more narrow focus of the proposed representation is appropriately designed to elicit the information most useful to FINRA in reviewing relationships that may affect the terms and arrangements entered into in connection with the public offering.

E. Paragraph (a)(4)(B)(v) of the Proposed Rule requires the filing of a "description of any securities of the issuer acquired and beneficially owned by any participating member during the review period." This requirement should be limited to a description of any securities-based *underwriting compensation* acquired during the review period by participating members. In other words, no description should be required to be filed in respect of securities that do not constitute underwriting compensation under the Rule including, for example, securities acquired in the secondary market in connection with the performance of bona fide customer facilitation activities, securities-based compensation that has already been counted in a prior or concurrent public offering, securities-based compensation received through qualifying Section 401 plans or similar plans, and securities acquired as a result of a conversion, exchange or option exercise where the original securities were acquired prior to the review period.

F. The Proposed Rule (*see* paragraph (a)(4)(C)) includes a new requirement to file a written notification to FINRA with respect to "underwriting compensation received or to be received pursuant to paragraph (f)(4), including a copy of any agreement governing the arrangement," in respect of a previously filed offering that has not been completed according to the terms of an agreement between the issuer and a participating member. Given the strict limitations on the receipt of compensation in such situations imposed by paragraph (f)(4) of the Proposed Rule, we do not see the need for such requirement and request that it be deleted. If FINRA is determined to retain the provision, we ask that FINRA provide a rationale for the imposition of this new burden and, at the very least, that it be limited to notice with respect to the receipt of termination fees (and not, for example, expense reimbursements and continuing rights of first refusal received in compliance with the provisions of paragraph (f)(4)).

2. The Exceptions from Underwriting Compensation for Certain Securities Acquisitions Should be Clarified and Expanded (Proposed Rule 5110(c))

A. SIFMA believes it is helpful to continue to include the so-called "venture capital" exceptions for securities acquired by participating members in connection with a loan or private placement (the "Venture Capital Exceptions") in the Proposed Rule. However, in light of the new definition of "underwriting compensation," which more properly focuses on the services being provided, we believe it is important for FINRA to state affirmatively that the Venture Capital Exceptions are non-exclusive safe harbors in connection with acquisitions of securities and that other securities acquisitions that do not meet one of these express safe harbors (or fall within other exceptions provided elsewhere in the Proposed Rule) will also be excluded from characterization as underwriting compensation (and the accompanying lock-up restrictions) if the acquisition of the securities by the participating member is not compensation for providing underwriting, allocation, distribution, advisory or other investment banking services in connection with the public offering.

B. We note that the Proposed Rule continues to limit the Venture Capital Exceptions to acquisitions of securities made "before the required filing date" for the offering. SIFMA believes the rationale underlying the Venture Capital Exceptions applies equally to acquisitions made *after* the required filing date and by depriving issuers of this important source of funding the Rule places a significant burden on capital formation without any countervailing issuer or investor protection benefit. Investments made post-filing can be particularly important if an offering is significantly delayed and the issuer finds itself in need of funding to remain afloat pending the consummation of the offering. An issuer will often turn to its bankers and traditional lending counterparties (who may be affiliated with the underwriters) during this time of need, and the uncertainty surrounding whether the potential investment may be deemed underwriting compensation and/or subject to FINRA's lock-up restrictions may force issuers to look elsewhere for such funding. Limiting such funding sources at this potentially perilous time can have significant consequences for an issuer and, at the very least, may increase the issuer's overall transaction costs. Accordingly, we believe if a particular transaction meets the applicable substantive criteria for exclusion pursuant to Proposed Rule 5110(c)(1), (2) or (3), it should not matter whether the investment decision was made before or after the required filing date and therefore urge FINRA to eliminate this timing restriction. Alternatively, FINRA should at the very least consider either (i) eliminating the pre-filing timing restriction with respect to paragraphs (1) and (2) of Proposed Rule 5110(c), which address securities acquired by certain types of affiliates of participating FINRA member firms or (ii) establishing for all of these exceptions a formal mechanism to "re-set" the required filing date in connection with significantly delayed offerings (*e.g.*, for offerings in which there have been no updates to SEC or FINRA filings for at least six months, the required filing date would be reset to the date of the first new filing made after the gap period).[8]

C. The Proposed Rule 5110(c) exceptions should be clarified to provide that the determination as to the availability of a particular exception (including, for example, as to which entities qualify as "institutional investors" for purposes of Proposed Rule 5110(c)(2) and (3)) is to be made by the participating member at the time of the acquisition of securities and on the basis of the information then known to the participating member. For example, if a month before the required filing date, a participating FINRA member acquires securities of the issuer in a private placement and believes it meets the exception for acquisitions of securities under Rule 5110(c)(3) at that time because no other FINRA

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[8] We note that in Amendment No. 4 to the 2004 Rule Change, FINRA stated that it has, at times, granted requests to exclude from underwriting compensation securities acquired within the review period in connection with significantly delayed offerings. We believe FINRA should formalize and codify this position.

members are then participating in the public offering, the affiliate should not have any fear that the exception would not later be available if, after the FINRA filing is made, it turns out that additional FINRA members will be participating in the public offering and such members or their affiliates also participated in the earlier private placement thereby causing the 51% "institutional investor" participation threshold not to be met.

D. For purposes of the exceptions under Proposed Rule 5110(c)(1) and (2), FINRA has modified the requirement that the investing affiliate be "primarily engaged in the business of making investments in or loans to other companies" by adding that this criteria may be met by the affiliate itself or "through a subsidiary it controls." We believe this proposed modification was made to address situations in which the investing entity is a newly formed vehicle and does not, outside the present investment, have a history of making such investments to "other companies." While we believe this is a useful clarification, we do not think the proposed language is sufficient to accomplish such purpose. Instead, we suggest that the provision be modified to require that "the affiliate is *or will be* primarily engaged in the business of making investments in or loans to other companies *or has been formed for the purpose of making this investment or loan by a parent that is directly or indirectly engaged in such activities*."

E. As in the current Rule, Proposed Rule 5110(c)(3) would limit the exception for "Private Placements with Institutional Investors" to "securities of the issuer purchased in, or received as placement agent compensation in connection with, a private placement ...." We support and agree with FINRA's rationale to increase the participating members' aggregate acquisition threshold from 20% of the total offering to 40%, but we believe the limitation to receipt of the securities as compensation for "placement agent" activities is unnecessary and should be removed. We note, for example, that securities-related compensation could be offered by an issuer in return for advisory or other services provided by a participating member in connection with the private placement, rather than for services as a "placement agent."

F. FINRA should provide an additional exception for securities acquired before or after the required filing date by a participating member in connection with a loan or a private placement in which securities (at the same price and with the same terms) were also acquired by certain types of "special" investors, including: (i) an investment company registered under the Investment Company Act of 1940, (ii) a fund or insurance company that meets the qualifications set forth, respectively, in FINRA Rule 5130(c)(2) or (3), (iii) a publicly traded company that is listed on a national securities exchange or a non-U.S. issuer that meets the quantitative designation criteria for listing on a national securities exchange, (iv) a benefit plan qualified under Section 401(a) of the Internal Revenue Code (provided that such plan is not sponsored by a participating member), (v) a state or municipality, or a state or municipal government benefits plan that is subject to state and/or municipal regulation, (vi) a sovereign wealth fund or similar investment vehicle, (vii) a bank as defined under Section 3(a)(6) of the Securities Exchange Act of 1934 or (viii) an organization described in Rule 15a-6(a)(4)(ii), provided that no participating member manages such entity's investments or otherwise controls or directs the management or policies of such entity and such entity or entities acquire in the aggregate at least 10% of the total offering.

G. FINRA should create (either as part of Proposed Rule 5110(c) or as an express carve-out listed in Supplementary Material .01(b)) an additional exception from underwriting compensation for acquisitions of securities before or after the required filing date by participating members pursuant to a U.S. or non-U.S. governmental or court-approved proceeding or plan of reorganization in which new securities are issued to and/or are available for purchase by existing security holders (including, for example, Bankruptcy or Tax Court proceedings) where such participating members receive or purchase such securities on the same terms as other similarly-situated security holders.

3. The Lock-Up Restrictions Should be Clarified and Further Modified (Proposed Rule 5110(d))

A. The Proposed Rule would expand the lock-up restriction from applying solely in connection with "public equity offerings" (other than offerings by an issuer that is eligible to file on SEC Form S-3/F-3 pursuant to standards for such forms in existence prior to October 21, 1992 (the "Pre-1992 S-3 Standards")) and covering only "unregistered" equity securities, to applying to all offerings and covering all securities – including, it appears, non-convertible/non-exchangeable debt securities and derivative instruments acquired at a fair price in a transaction related to the offering and non-listed securities of an issuer acquired in a public market transaction, unless the "security" is of an issuer that meets the registration requirements of SEC Form S-3/F-3/F-10 pursuant to the current SEC standards for use of such forms ("Current S-3 Eligible Issuers").

While we support the new exclusion for securities of Current S-3 Eligible Issuers, we do not believe the expanded application of this provision to offerings and instruments that have not previously been covered is warranted, nor has any rationale been offered for such expansion. Thus, we believe this provision should continue to apply solely to public offerings of equity and equity-linked securities, should cover only equity and equity-linked securities received as underwriting compensation by participating members in offerings not registered under the Securities Act of 1933 (the "Securities Act") and should provide an express carve-out for fair price derivatives. Further, we believe the proposed exclusion for securities of Current S-3 Eligible Issuers should be clarified to expressly provide that the exclusion also applies to derivative instruments entered into with such issuers.

B. In NTM 04-13,[9] FINRA noted that fair price derivatives acquired during the review period in transactions unrelated to the offering were not subject to the lock-up restrictions of the Rule, but that unregistered equity securities received in settlement of such derivatives were subject to such lock-up restrictions. FINRA's rationale for this position was that "underwriters holding significant amounts of unregistered equity could

[9] *See* NTM 04-13 at p. 119.

dilute or manipulate the market for an issuer's securities immediately following a public offering, especially in the case of thinly traded issuers." FINRA then stated that it would "consider, on a case-by-case basis, whether to exempt from the Rule those unregistered equity securities necessary as the result of settlement of fair price derivatives. In conducting such reviews, the Department will consider whether the lock-up restriction is interfering with bona fide hedging activity that benefits an issuer and its shareholders." Given that FINRA has now had 13 years of experience with the Rule as amended in 2004 and we are not aware of any abuses that were identified by FINRA in the intervening period, we request that FINRA reconsider its position and expressly exempt from the lock-up restrictions of Proposed Rule 5110(d) any securities received in connection with the settlement or termination of a derivative instrument received outside the review period or during the review period in a transaction unrelated to the public offering. This would be consistent with the idea, as expressed throughout the Proposed Rule, that securities received as the result of a conversion or exercise of securities that are not considered underwriting compensation are themselves not underwriting compensation and thus not subject to the lock-up provisions of the Rule. We note that this clarification could be made by adding an additional exception in Proposed Rule 5110(d)(2) or by modifying item (14) of Supplementary Material .01(b) to read "securities acquired as the result of a conversion *or exchange*[10] of securities originally acquired prior to the review period and securities acquired at termination or in settlement of a derivative instrument entered into prior to the review period or during the review period in a transaction unrelated to the public offering."

C. Proposed Rule 5110(d), like the current Rule, prohibits participating members from selling securities received as underwriting compensation in the public offering itself. SIFMA believes such restriction is not warranted and requests that FINRA reconsider this limitation or provide a rationale for its continued imposition. Given the issuer's knowledge and consent to the inclusion of such securities as part of the registered offering, and the corresponding disclosure to the investing public of such inclusion, we can see no harm that the restriction is intended to prevent. Moreover, if FINRA's concern here is premised on a potential conflict of interest due to receipt of offering proceeds by a participating member, this should be adequately addressed by the provisions of Rule 5121.

D. Exception (ii) of Proposed Rule 5110(d)(2)(A) provides that the lock-up restrictions will not apply if the "aggregate amount of securities of the issuer beneficially owned by a participating member does not exceed 1% of the securities being offered." SIFMA believes that the 1% threshold should be tied to the amount of securities received as underwriting compensation during the review period rather than more broadly to all securities held by the participating member. Accordingly, the lock-up restrictions should not apply to securities received during the review period as underwriting compensation if the amount of such securities does not exceed 1% of the securities being offered in the public offering.

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[10] We believe Item 14 should be modified to include "or exchange" in any event.

E. We believe the exemption set forth in Proposed Rule 5110(d)(2)(A)(iv), which provides an exception from the lock-up restrictions for certain investment funds, should be modified to allow for the sale or other disposition of the securities by investment advisers registered under the U.S. Investment Advisers Act of 1940, even if such advisers are affiliated with a participating FINRA member. Such advisers are separately regulated and have a fiduciary duty to act in the best interests of their clients, and the lock-up restriction may well interfere with that regulatory responsibility. Accordingly, we suggest the following revision to this provision:

> "(iv) the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that (a) no participating member *(other than a participating member that is registered as an investment adviser under the U.S. Investment Advisers Act of 1940 and is acting in accordance with its responsibilities thereunder)* manages or otherwise directs investments by the fund, and (b) participating members in the aggregate do not own more than 10% of the equity in the fund."

F. The duration of the lock-up period imposed by Proposed Rule 5110(d) is the same 180 days set forth in the current Rule. In Amendment No. 6 filed in connection with the 2004 Rule Change, FINRA explained its rationale for this period by stating that the "180-day lock-up is consistent with the industry practice to impose a 180-day lock-up on securities of the issuer held by its officers, directors and other insiders." While we agree that a 180 day lock-up is common in connection with IPOs,[11] it is not common in connection with follow-on or secondary offerings. We therefore request that FINRA consider a bifurcated approach that is consistent with these distinct offering practices. If FINRA agrees to such modification, we suggest that the 180 day lock-up period be imposed solely in connection with IPOs, a much shorter period (*e.g.*, 30 days) be imposed in connection with certain other offerings by smaller issuers and no lock-up period be imposed in connection with offerings of securities that have a bona fide public market (as such term is defined in Rule 5121).[12]

In this regard, we note that in Amendment No. 4 to the 2004 Rule Change, FINRA stated that the purpose of the lock-up was to:

- protect the issuer and public investors by ensuring that the public market for the securities sold by participating members has an opportunity to develop

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[11] We note, however, that the insider lock-up is subject to waiver by the underwriters, whereas the FINRA lock-up is generally not.

[12] We note that certain of our comments relating to Rule 5121, including our comment with respect to the definition of "bona fide public market," are contained in the SIFMA Capital Formation Letter. Given the significant interrelation between Rules 5110 and 5121 and the cross-incorporation by reference of key definitions used in the two rules, it is vital that FINRA also consider these Rule 5121 comments in conjunction with its general review of Rule 5110 and its consideration of the comments regarding the Proposed Rule set forth in this letter.

prior to the sale of securities into the market by the underwriters and related persons that dilutes the public investors; and

- prevent opportunities for fraud and manipulation in the after-market of a company's initial public offering or an offering of securities that are not sufficiently liquid when a member is an underwriter, actively trades the securities, and is a selling securityholder.

Accordingly, we believe the bifurcated approach suggested above is consistent with, and indeed would more properly address, FINRA's concerns as outlined in connection with the 2004 Rule Change with regard to the ability of participating members to sell securities in the market following the public offering.

4. <u>The Non-Cash Compensation Provisions Set Forth in the Rule Should be Eliminated or Modified to Address the Inherent Inconsistencies With Other Aspects of the Rule (Proposed Rule 5110(e))</u>

The Proposed Rule continues to include the "non-cash compensation" provisions set forth in the current Rule. FINRA notes that these provisions are part of a more general comprehensive review of the various rules in which such similar versions of the non-cash compensation provisions appear and, accordingly, has decided to include these provisions in their present form in the Proposed Rule. However, if the non-cash compensation provisions included in Proposed Rule 5110(e) are applied literally, participating members would be unable to receive as underwriting compensation certain common forms of non-cash compensation such as securities, derivatives and rights of first refusal, which is plainly inconsistent with other provisions in the Rule.

We recognize that the same non-cash compensation provisions appear in the current Rule and such provisions have not been strictly applied by FINRA staff in the past. Nonetheless, we believe that the Proposed Rule affords the perfect opportunity to clarify the situation and eliminate the inherent inconsistencies between these provisions and the rest of Rule 5110. While our recommended approach is to eliminate these provisions in their entirety for purposes of Rule 5110, a simple fix short of this would be to modify the first sentence of Proposed Rule 5110(e)(2) as follows:

> "In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision<u>, *or as permitted elsewhere in this Rule*</u>."

Alternatively, if FINRA is not inclined to make any textual changes to these provisions in advance of its comprehensive review, an interim solution would be to add guidance to the Supplementary Materials addressing this issue and providing that the receipt of non-cash compensation items (including securities, derivatives and rights of first refusal) that are permitted under other provisions of Rule 5110 will not be prohibited by, or deemed inconsistent with, the restrictions of paragraph (e) of Rule 5110.

5. <u>The Exemptions From Filing Should be Expanded (Proposed Rule 5110(g)(1))</u>

A. The Proposed Rule attempts to streamline the Rule's filing requirements by incorporating the current Rule's exemption for offerings by issuers that meet the Pre-1992 S-3 Standards into a new definition of "experienced issuer" (see our discussion below with respect to this term), but otherwise this filing exemption is largely unchanged. SIFMA and its member firms have long urged FINRA to update this filing exemption to reflect current SEC standards for Form S-3 eligibility and we continue to believe such change is appropriate.[13]

In NASD Notice to Members 93-88 (November 1993) ("NTM 93-88"), FINRA noted that "[o]n October 21, 1992, the SEC approved an amendment to expand the availability of Form S-3 and to make Rule 415 registrations available to additional issuers as part of an effort to reduce the cost of financing through the securities markets." Nonetheless, FINRA determined at that time to keep the filing exemption for Form S-3 issuers routed to the Pre-1992 S-3 Standards because it did not yet have sufficient information with respect to the newly qualified issuers to reach a conclusion that the filing exemption should be extended. FINRA noted, however, that it would "undertake a one-year review" of offerings filed by such issuers "to determine whether the market forces related to such offerings result in the presence of fair and reasonable underwriting terms and arrangements." It has now been nearly 25 years since this statement was made and we are still awaiting evidence as to the abuses the imposition of the more stringent Pre-1992 S-3 Standards are meant to address.

If FINRA is truly committed to modernizing its rules, we fervently believe that the time has come for FINRA to embrace the present and modify this filing exemption to eliminate the additional requirement that issuers filing offerings on Form S-3 need to satisfy the Pre-1992 S-3 Standards (we note in this regard that compliance by FINRA members with the Rule's other provisions would continue to be required). If such change is not made, FINRA should at the very least provide a filing exemption for offerings by "well-known seasoned issuers" (or "WKSIs") that meet current Form S-3 standards.

B. The Proposed Rule (like the current Rule) requires that public offerings that otherwise meet a filing exemption nonetheless be filed under Rule 5110 if participation by a "qualified independent underwriter" (or "QIU") is required pursuant to FINRA Rule 5121.[14] We believe this filing requirement is an anachronistic remnant from an earlier time

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[13] References to Form S-3 in this context are deemed to refer also to Form F-3 and F-10.

[14] Rule 5121(a)(1)(A) provides that a QIU will be required (absent an exemption) if "the member(s) primarily responsible for managing the public offering [have] a conflict of interest." As discussed in the SIFMA Capital Formation Letter, the reference to "primarily managing the public offering" continues to confuse and frustrate member firms and should be further clarified.

in which Rule 5121 (or more precisely, its predecessor NASD Rule 2720) required member firms to obtain formal approval from FINRA as to the ability to act as a QIU in connection with a public offering and mandated the delivery by the QIU of a pricing opinion. Given that these two requirements have since been eliminated, we do not believe the additional filing requirement is justified or warranted, and in fact, such requirement unnecessarily increases the issuer's transaction costs and alters the composition of underwriting syndicates in ways that do not further investor or market protection.

For example, if an issuer that meets the Pre-1992 S-3 Standards files a shelf registration statement today, that offering will be exempt from filing with FINRA. One year from now, the issuer plans to do a high yield debt offering off the shelf and hires Investment Bank ABC to act as managing underwriter. The proceeds from the takedown will be used in part to reduce the balance of a credit facility that was entered into with an affiliate of Investment Bank ABC and, as a result, more than 5% of the net offering proceeds will be received by a participating member. Because of the need to appoint a QIU in the context of the takedown, the shelf would now need to be filed, requiring the issuer to pay the FINRA filing fee for the entire shelf (an amount up to $225,500) which otherwise would not have been necessary. The issuer could, of course, decide not to pay down the credit facility or to fire Investment Bank ABC or relegate the firm (assuming there are multiple underwriters engaged for the offering) to a passive co-manager role in order to avoid paying the fee, but this hardly seems like an appropriate incentive.[15] Because this requirement imposes additional burdens on the issuer and interferes with the issuer's decision process without any redeeming regulatory purpose, FINRA should remove the Rule 5110 filing requirement to the extent it is triggered solely by the need to appoint a QIU under Rule 5121.

Alternatively, if FINRA is unwilling to eliminate the QIU filing trigger in its entirety, we ask that FINRA consider removing the requirement to file (where a Rule 5110 filing exemption exists) to the extent the designation of a QIU is required solely due to the receipt of offering proceeds by a participating member. Doing so would be consistent with the status of Rule 5110 and 5121 as they existed prior to the amendments made to such rules in 2009. Prior to the 2009 amendments, the receipt of offering proceeds conflict was included in Rule 5110 and required substantive compliance with the QIU designation, disclosure and other requirements of Rule 5121 (then NASD 2720), but did not alter the ability to continue to rely on the filing exemptions provided by Rule 5110. We believe FINRA should, at the very least, return to this state of play.

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[15] Indeed, this could also result in other adverse consequences for the issuer if it has previously granted Investment Bank ABC a right of first refusal to act in a particular capacity in the offering.

6. Streamline the Exemptions From Rule Compliance by Clarifying and Modifying the Definition of Public Offering (Proposed Rule 5110(g)(2)/ Proposed Rule 5110(i)(18))

SIFMA supports the addition of new exemptions for certain public offerings of insurance contracts and securities of unit investment trusts, and believes the clarification that offerings effected pursuant to SEC Rule 144A and Regulation S are indeed exempt from the Rule's coverage (as has long been understood to be the case) is helpful. However, we believe that Rule 144A and Regulation S offerings, together with other offerings effected in accordance with the private placement exemptions from registration under the Securities Act (including pursuant to Securities Act Section 4(a)(2) and Regulation D thereunder), should be exempt not by virtue of an exemption under Proposed Rule 5110(g)(2), but because they are simply not "public offerings."

As discussed further in Section 8.D below, as part of its effort to streamline Rules 5110 and 5121, FINRA has included in the Proposed Rule a new definition of "public offering" that eliminates the carve-outs currently set forth in Rule 5121's definition of "public offering" (which carve-outs relate to certain types of securities offerings that are commonly understood not to constitute offerings to the "public"), thereby substantially broadening the definition. We do not believe, however, that FINRA intended to alter the substance or scope of this important definition. Accordingly, we urge FINRA to adopt a definition of "public offering" that retains these important exceptions and to remove the offerings listed in Proposed Rule 5110(g)(2)(A), (B), and (C), since such offerings would already be exempt from the Rule's coverage by virtue of the definition of "public offering" itself. Doing so would bolster the general understanding and premise of the Rule that only offerings to the "public" are (unless otherwise exempt pursuant to paragraph (g)(2)) required to comply with the provisions of the Rule.

7. Request for Clarification With Respect to Exemption Requests (Proposed Rule 5110(h))

Proposed Rule 5110(h) provides that FINRA may in "exceptional and unusual circumstances" exempt a member firm from any or all of the provisions of the Rule as FINRA deems appropriate. The current Rule provides that "appropriate FINRA staff, for good cause shown" may grant a conditional or unconditional exemption from any of the Rule's provisions. We would like to understand better the rationale for this change and whether the change is intended to limit the circumstances in which an exemption may be sought.

8. Certain Definitions Should be Modified and/or Clarified (Proposed Rule 5110(i))

A. As noted above, the Proposed Rule includes a new definition for "experienced issuers," which essentially are issuers that meet the Pre-1992 S-3 Standards. While we believe FINRA should abandon the reference to such decades-old standards and embrace the SEC's current Form S-3 thresholds (which would render the new term unnecessary), we provide the following comments in the event FINRA determines to maintain its present position.

We understand that FINRA's goal in incorporating the criteria for the S-3 filing exemption directly into the Rule was to make compliance easier for member firms since they would no longer be required to find a copy of a pre-October 1992 version of Form S-3 or NTM 93-88 (which includes the old Form S-3 as an attachment). However, by doing so, FINRA has also effectively eliminated the SEC history and interpretive guidance that accompanies the Form S-3 eligibility requirements. In addition, the terminology used by FINRA in the definition of "experienced issuer" differs from the terminology used by the SEC for purposes of current Form S-3. These differences are likely to lead to confusion and increased costs for issuers and participating members as they attempt to make the calculations necessary to determine the availability of the exemption.

For example, FINRA's definition of "affiliate" differs substantially from the SEC Rule 405 definition used for purposes of Form S-3, which could lead to differences in the public float calculation. In addition, for purposes of assessing aggregate market value, the definition of "experienced issuer" looks solely to the issuer's "voting stock," while Form S-3 references the issuer's "voting and non-voting common equity."[16] Because of these inconsistencies, we believe the inclusion of the "experienced issuer" definition in its present form may actually create more issues than it was intended to resolve.

Accordingly, we suggest FINRA consider modifying the definition of "experienced issuer" as follows

> *"The term 'experienced issuer' means an issuer that (i) meets the registrant requirements specified in paragraph I.A of SEC Form S-3, except that for purposes of paragraph I.A.3 thereof, the reference to "twelve calendar months" shall be deemed to refer instead to "36 calendar months" and (ii) has an aggregate market value of outstanding voting and non-voting common equity held by non-affiliates (as calculated pursuant to General Instruction I.B.1 of Form S-3) of (a) at least U.S.$150 million or (b) at least U.S.$100 million and the issuer has had an annual trading volume of its common equity of at least three million shares (or share equivalent)."*

B. The Proposed Rule retains the definition of "institutional investor" in a form largely unchanged from the current Rule. Such definition, however, remains extremely problematic and difficult to use, thereby rendering the two Venture Capital Exceptions in which it appears largely unworkable (*see* Proposed Rule 5110(c)(2) and (3) and current Rule 5110(d)(5)(B) and (C)). In particular, given the expansive definition of "participating

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[16] SEC Rule 405 defines the term "common equity" as "any class of common stock or an equivalent interest, including but not limited to a unit of beneficial interest in a trust or a limited partnership interest." (We note that Rule 5121 also defines "common equity," but in a different manner.)

member" (which includes *all* associated persons of a member firm and their immediate family – a group that, for all but the smallest member firms, will be significantly large) and the extremely low aggregate "equity interest" thresholds (respectively, 5% for a publicly owned entity and 1% for a nonpublic entity) for participating members, it is difficult to ascertain whether an entity truly qualifies as an "institutional investor." We do not believe the time and cost associated with making such determination is warranted or necessary to achieve the fundamental purpose underlying these provisions. Instead, we strongly believe the focus of the definition should be on whether a participating member *manages* the investor's investments or otherwise *controls* or *directs* the investment decisions of the investor and thus suggest the following revision to such definition:

> "For the purposes of paragraph (c), the term "institutional investor" means person that has an aggregate of at least *U.S.$50* million invested in securities in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members manage the institutional investor's investments or *otherwise control or direct the investment decisions of such investor*."

Alternatively, if FINRA does not want to delete the equity interest element of the definition, we propose that (i) the reference to "equity interest" be changed to "beneficial ownership" (as such term is defined in Rule 5121), (ii) the thresholds for both public and nonpublic entities be raised to 15% and the reference to "entity" be changed to "investor" (due to the incorporation by reference in Rule 5110 of the specific definition of "entity" included in Rule 5121, which does not make sense in this context), and (iii) the calculation of the beneficial ownership threshold be limited to ownership by the participating FINRA member firm and its affiliates (*i.e.,* the calculation should not include associated persons that are not otherwise "affiliates" of the member firm or immediate family of such associated persons). While we fervently believe the correct approach would be to revise the institutional investor definition to focus on the investment "control" aspect of a participating member's involvement as provided above, this alternative suggestion would at least make the institutional investor definition more manageable and the exceptions more usable.

C. We note that the Proposed Rule carves out the "issuer" from the definition of "participating member."[17] We agree that this is a useful clarification and will help prevent inadvertent overlap between the two definitions. For similar reasons, we suggest that a comparable carve-out be included in the definition of "issuer" in respect of participating members. We also note that the proposed definition of "issuer" includes the reference to an "entity" offering its securities to the public. This reference may be confusing given the fact that "entity" is a defined term in Rule 5121 and such term, which is incorporated by reference in Rule 5110, excludes certain types of issuers including direct

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[17] In this regard, however, we suggest that the definition be modified to provide that: "The term 'participating member' means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family*, provided that such term shall not include the issuer*."

participation programs (DPPs) and real estate investment trusts (REITs). Accordingly, we propose the following modifications to address these issues:

> "The term 'issuer' means the *registrant or other person offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant, such other person or selling security holder (other than an affiliate that is a participating member)*, and the officers or general partners, and directors thereof."

D. As discussed in Section 6 above, while we applaud FINRA's attempt to streamline and clarify certain of the defined terms and other provisions of the Rule, we believe the new definition of "public offering" in the Proposed Rule is problematic and will foster additional confusion as to the Rule's coverage universe. As written, the term appears to cover ***all*** offerings – including traditional private placements and Regulation D, Rule 144A and Regulation S offerings – if made pursuant to an "offering document" (a term that is not separately defined and could perhaps lead some participants in certain types of private transactions to forego the provision to investors of more fulsome disclosure materials in order to avoid falling within the scope of the definition), which we do not believe is FINRA's intent. We do not think this problem is solved by simply including these types of offerings as separate exemptions from Rule compliance under Proposed Rule 5110(g)(2). In particular, the inclusion of Regulation S, Rule 144A and other private placements in the definition of "public offering" is not only inherently confusing (as these types of transactions have previously not been thought to constitute offerings to the "public"), but is also inconsistent with "Plain English" drafting principles.[18]

Moreover, we note that the new "public offering" definition would be incorporated by reference in Rule 5121 (replacing the current definition of "public offering" in that rule, which now explicitly carves out these traditional "non-public" offerings) and thus is also likely to create confusion from a "Plain English" perspective in the context of that rule. Although we appreciate that FINRA amended Attachment A to RN 17-15 on May 24, 2017 to expressly state that the offerings excluded under Rule 5110(g)(2) would likewise be excluded from compliance with Rules 2310 and 5121 – thereby resolving the inadvertent application of those rules to offerings that have not previously been covered – we believe additional linkages and cross-referencing among these rules will be required to make this intent clear.[19]

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[18] Indeed, we wonder whether a definition of "public offering" is actually now necessary, given that the Proposed Rule appears to be constructed to apply to all offerings other than those expressly excluded under Rule 5110(g)(2).

[19] For example, there will need to be additional provisions in Rule 5121 and Rule 2310, with a cross-reference back to Rule 5110, stating that "Offerings excluded from compliance with Rule 5110 pursuant to paragraph (g)(2) thereof are also excluded from compliance with this rule."

Accordingly, while we do agree that it makes sense to move the "public offering" definition from Rule 5121 to Rule 5110, we believe FINRA should do so without modifying the substance of the current definition. As a result, FINRA would achieve its goal of streamlining its rules without any loss in clarity or comprehension.

E. SIFMA believes that the definition of "underwriting compensation" has been substantially improved in the Proposed Rule and supports the removal of the current Rule's reference to "items of value." However, we believe the "underwriting compensation" definition, which continues to refer to compensation received from "any source," should be further narrowed to eliminate this overly broad phrase and focus instead on benefits received from or at the direction of the issuer. Alternatively, if FINRA is unwilling to make this change and eliminate the phrase "any source" altogether, the definition should at a minimum be more narrowly tailored to address FINRA's specific concerns in this regard. For example, the definition could be modified as follows:

> "The term 'underwriting compensation' means any payment, right, interest or benefit received or to be received by a participating member from *the issuer or other person acting on behalf of the issuer for providing underwriting, distribution, advisory or* other investment banking services in connection with a public offering, *and any payment, right, interest or benefit received or to be received by a participating member from any other person in return for the allocation to such person (or an account designated by such person) of securities in a public offering (other than the purchase price of the securities allocated, ordinary brokerage commissions or regular account maintenance fees)*.[20]

We also believe FINRA should (whether or not it accepts our suggestions above) remove the last sentence of Proposed Rule 5110(i)(22). This sentence states that "[i]n addition, underwriting compensation shall include finder fees, and underwriter's counsel fees, including expense reimbursements and securities." We think that this sentence, which presumably is intended to clarify the scope of the definition, actually creates confusion as it implies that certain items such as finder fees and underwriter's counsel fees are counted as compensation even if not reimbursed to the participating member. Moreover, the sentence is unnecessary given that the substance of this statement – along with other helpful clarifications as to what is considered or not considered underwriting compensation – is included in Supplementary Material .01.

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[20] We understand that the concern FINRA was attempting to address by broadening the scope of this provision to include the receipt of a payment or benefit from "any source" (rather than just focusing on arrangements with the issuer) was the payment by investors of excessive commissions or promises of additional securities purchases as an inducement to receive an allocation of securities in certain "hot" IPOs in late 1990s and early 2000s. In this regard, we note that SEC Regulation M, as discussed in SEC Staff Legal Bulletin No. 10 (August 25, 2000), prohibits solicitations and "tie-in" agreements for aftermarket purchases, and FINRA Rule 5131 now specifically addresses impermissible "spinning" arrangements in connection with new issue allocations.

9. Comments and Suggestions for Proposed Revisions to the Supplementary Material

A. The lead-in to paragraph (a) of Supplementary Material .01 should say "The following are examples of payments or benefits that are considered underwriting compensation *if received during the review period for underwriting, allocation, distribution, advisory or other investment banking services provided in connection with the public offering*:"

B. Items (3) and (4) of Supplementary Material .01(a) should be revised to clarify that such items (*i.e.*, underwriters' counsel fees and finder fees) are counted as underwriting compensation solely to the extent they are reimbursed to, or paid on behalf of, the participating members.

C. Item (7) of Supplementary Material .01(a) should be revised to clarify that common stock and other equity securities will not be considered underwriting compensation if purchased or acquired in a transaction that complies with Proposed Rule 5110(c) or is otherwise excluded as underwriting compensation pursuant to other provisions of the Proposed Rule (including as set forth in Supplementary Material 01(b)).

D. Item (9) of Supplementary Material .01(a) should eliminate the arbitrary 1% valuation assigned to rights of first refusal. While we agree that rights of first refusal should be included as "underwriting compensation" for disclosure purposes, we can see no reason to assign a value to such benefit. Instead, like the treatment of fair price derivatives under the current Rule and Proposed Rule, we suggest that rights of first refusal be deemed underwriting compensation but have zero compensation value (unless the agreement in which the right is granted contains a dollar amount contractually agreed to by the parties to waive the right, in which case that amount should be included).

E. Item (13) of Supplementary Material .01(a) provides that "underwriting compensation" includes "any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering." Although this provision is consistent with a similar provision in the current Rule (*see* Rule 5110(c)(3)(A)(xiii)), we do not understand the rationale for the inclusion of such compensation if it was received in accordance with the requirements of Proposed Rule 5110(f)(4). Why, for example, should the reimbursement of *bona fide* accountable expenses for a prior non-completed offering count as compensation for a later public offering? What abuse is being addressed here? In any event, this provision should make clear that the prior compensation would only be captured if it is received within the review period for the new public offering.

F. Assuming FINRA determines to retain the "Non-Cash Compensation" section (see our discussion in Section 3 above), we do not believe that gifts and business entertainment provided in compliance with the limits set forth in Proposed Rule 5110(e)(2)(A) or (B) (which allow for nominal gifts and occasional meals and sporting events) should be counted as "underwriting compensation," with the corresponding need to disclose such items in the FINRA filing and prospectus (as provided in Item (14) of Supplementary Material .01(a)). There is simply no reasonable rationale, and no investor protection goal, served by the imposition of a requirement on member firms to itemize these nominal and occasional events in this context.

G. Item (2) of Supplementary Material .01(b) should be broadened to provide an exclusion from underwriting compensation for "cash compensation *received for providing services in* a private placement or for providing or arranging for a loan, credit facility or for services in connection with a merger or acquisition." For the same reasons noted in Section 2.D of this letter, we believe the limitation to receipt of cash compensation solely for acting in a "placement agent" capacity is unnecessarily narrow and should be removed.

H. Item (11) of Supplementary Material .01(b) should be modified to remove the reference to "listed" (*i.e.*, all securities purchased in public market transactions should be excluded from underwriting compensation, regardless of whether they are "listed").

I. As noted above in Section 2.B, Item (14) of Supplementary Material .01(b), should be revised to reference a "conversion *or exchange*" and should also include (if a new exception is not added to Proposed Rule 5110(d)(2)) a reference to "securities acquired at termination or in settlement of a derivative instrument entered into prior to the review period or during the review period in a transaction unrelated to the public offering." (Alternatively, this latter modification could be included at the end of Item (19) of Supplementary Material .01(b).)

J. Item (19) of Supplementary Material 01(b) should be expanded to also exclude from characterization as underwriting compensation non-convertible or non-exchangeable debt securities and derivative instruments that are acquired or entered into at a fair price in a transaction related to the public offering. Under the current Rule, and as provided in Supplementary Material .04, such securities and derivatives are considered underwriting compensation but will have no compensation value. SIFMA believes, however, that such securities and derivatives when entered into at a "fair price" should not be considered underwriting compensation for the public offering. Indeed, the "fair price" qualification should provide sufficient evidence that such securities and derivatives are by their very nature not underwriting compensation. SIFMA would, however, agree that such arrangements should continue to be disclosed in the prospectus for the public offering since they are entered into in transactions related to the public offering.

K. We believe Supplementary Material .01(b) should contain an additional item clarifying that underwriting compensation does not include any cash compensation, securities or other benefit received by a person that was not, at the time of acquisition, an associated person, immediate family or affiliate of a participating FINRA member firm.

L. Supplementary Material .01(b) should also contain an additional item expressly excluding from underwriting compensation any cash compensation, securities or other benefit received by an associated person, immediate family or affiliate of a participating FINRA member firm if the FINRA member or its parent or other affiliate is issuing its own securities in the public offering.

M. SIFMA supports FINRA's decision to remove the current Rule's complex and outdated formula for valuation of options, warrants and convertible securities and instead allow firms to use a commercially available valuation method for such securities (*see* Supplementary Material .02), but we request additional guidance as to precisely what FINRA expects to be filed pursuant to Proposed Rule 5110(a)(4)(B)(iii) in respect of such methodology. For example, if the Black-Scholes model is used to value options, would the firm be required to file the model itself or only a reference to the fact that the Black-Scholes model was used? Moreover, in addition to commercially available models, SIFMA believes that the use of proprietary valuation models should be permitted if the firm uses such models in the ordinary course of its business to value securities of a similar type and files a description of the methodology with FINRA as required by Proposed Rule 5110(a)(4)(B)(iii) (which should be accorded confidential treatment under paragraph (a)(4)(D) of the Rule).

With respect to the valuation of non-convertible securities, however, we believe FINRA inadvertently left out an important element from the current Rule. Specifically, the Proposed Rule (like the current Rule) should allow firms to value securities that are currently trading in the secondary market based on the difference between the market price at the time of acquisition (rather than the public offering price) and the acquisition cost.

N. As noted in Section 8.H above, we believe that non-convertible or non-exchangeable debt securities and derivative instruments acquired at a fair price in a transaction related to the public offering should not be considered "underwriting compensation" for the public offering. To the extent FINRA is unwilling to accept this change, however, we believe that Supplementary Material .04 should at least be modified to clarify that (1) "non-convertible or non-exchangeable debt securities and derivative instruments acquired *from or entered into with the issuer* in a transaction related to the public offering and at a fair price will be considered underwriting compensation but will have no compensation value" and (2) any securities or other payment received by a participating member during the review period in connection with the settlement or termination of a derivative instrument that was entered into at a fair price in a transaction related to the public offering will, like the derivative instrument itself, have no compensation value (as is set forth in the current Rule). In addition, we note that if our suggested change is not made Proposed Rule 5110(f)(7), which prohibits certain terms in connection with "the receipt of underwriting compensation consisting of any option, warrant or convertible security," should be modified to exclude fair price derivatives.

In addition, in paragraph (b) of Supplementary Material .04, we suggest the following changes in the carve-out of certain instruments from the fair price definition:

> "A derivative instrument or other security received *as compensation* for acting as a private placement agent for the issuer, for providing a loan, credit facility, merger, acquisition or any other service, including underwriting services, *will not be deemed to have been entered into or acquired at a fair price*."

We believe the foregoing changes would clarify that securities and instruments that are intended to be compensatory in nature would not be viewed as having been acquired or entered into at a fair price. Otherwise, the reference to "any other service" could be broadly read to include, for example, the agreement by the participating member to enter into the derivative itself, which would render the fair price definition meaningless.

* * *

SIFMA appreciates this opportunity to comment on the proposed amendments to Rule 5110 and thanks FINRA in advance for its consideration of this submission. If you have any questions or require further information with respect our comments, please do not hesitate to contact the undersigned or SIFMA's outside counsel, Dana G. Fleischman of Latham & Watkins LLP, at (212) 906-1220.

Respectfully submitted,

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Capital Markets Division
SIFMA
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cc: Robert W. Cook, President and Chief Executive Officer
Robert L.D. Colby, Chief Legal Officer
Joseph E. Price, Senior Vice President and Counsel,
Corporate Financing/Advertising Regulation
Paul M. Mathews, Director, Corporate Financing Department
Kathryn M. Moore, Associate General Counsel, Office of General Counsel
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July 14, 2017

VIA E-MAIL (pubcom@finra.org)

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 17-15: Corporate Financing

Dear Ms. Mitchell:

On behalf of the Alternative & Direct Investment Securities Association ("**ADISA**")[1], we are submitting this comment letter regarding the Regulatory Notice 17-15: Corporate Financing (the "**Notice**") to the FINRA Corporate Financing Rule 5110 (the "**CF Rule**"). ADISA appreciates the opportunity to provide comments on behalf of its members.

The revisions to the CF Rule are significant. However, the comments requested in the Notice include the following:

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 5100 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 this offerings? What if any improvements could FINRA adopt to its treatment of Regulation A+ offerings?

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[1] ADISA (Alternative & Direct Investment Securities Association), is the nation's largest trade association for the non-traded alternative investment space. ADISA represents over 4,000 financial industry members, reaching over 30,000 investment professionals (with over $142 billion AUM) who handle over 1 million investors.

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 offering to the public. 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?

ADISA believes that many of the proposed changes to the CF Rule will be beneficial to its members; however, ADISA has the following specific comments on the Notice and its request for comments.

Extending Time Limits for Filings

ADISA commends FINRA on extending the time limits for filing public offerings through the Public Offering Filing System from one business day to three business days. ADISA believes that such extension of time will enable filers to meet the filing deadlines but will also enhance the accuracy of such filings providing extra time for review by all parties required to approve such filings.

Filing of Amended Documents

The Notice modifies the requirements with respect to filing amendments to documents to only require the filing of marked pages of those documents if there are "changes to the offering and the underwriting terms and arrangements." See CF Rule 5110(a)(4)(A)(iii). One could expect that any amendments to a registration statement or other offering document (and its related exhibits) would constitute a change "to the offering" and/or the "underwriting terms and arrangements." This change makes it more confusing for a FINRA member and its counsel to determine whether to file marked pages to an amended document. As a result, ADISA does not believe that any changes in the filing of amendments would occur. A clarification with respect to FINRA's intentions would be welcome in connection with this proposed change.

Disclosure of Aggregate Compensation

ADISA also commends FINRA for changing the disclosure requirements to only require the aggregate amount of all compensation to be disclosed, other than discounts and commissions, in the Plan of Distribution section rather than requiring each category of compensation to be disclosed separately. Given the nature of many of ADISA member's offerings, it is difficult to estimate the exact amounts to be allocated to each particular category of compensation. An aggregate number should be sufficient to protect investor's interests while at the same time providing issuers and FINRA members with the benefits of not having to specifically allocate dollars to each various category of compensation.

Changes to Lockup Restrictions

ADISA does, however, take issue with respect to the change in the lockup restrictions from the date of effectiveness to the commencement of sales. ADISA believes that "commencement of sales" can be more vague and hard to determine rather than a definitive date of effectiveness. Many of ADISA member's offerings are "best efforts" and there can be a significant time lag between the date of effectiveness and the date of first sale (or the breaking of escrow). If the lockup restrictions do not begin until the commencement of sales, is that the date selling agreements are entered into, the date that the first subscription agreement is received, the date that escrow is broken, or some other date? The date of effectiveness is a date certain that is publicly available on the SEC's website and would provide clarity to all participants in the offering rather than a date that will be more difficult to determine and harder yet to notify the holders of the stock subject to such restrictions.

In addition, while a 180-day lockup period would be appropriate for an initial public offering, it does not appear that a 180-day lockup period would be appropriate with respect to follow on offerings. ADISA would recommend a 30 to 45 day lockup period with respect to follow on offerings.

Regulation A+ Offerings

With respect to Regulation A+ offerings, ADISA members believe that FINRA should be more responsive to the review and clearance of filings made pursuant to Regulation A+. The intent of the CF Rule is to protect issuers from FINRA members who would otherwise be able to demand unreasonable and unfair compensation in order to raise capital on behalf of small businesses. ADISA believes that there must be a balance between impeding capital raising activities by issuers represented by competent counsel and protecting smaller, more unsophisticated issuers who are not so represented and could be harmed without FINRA's oversight. Many ADISA members utilize Regulation A+ and believe that extensive and long reviews of those offerings have impacted their ability to effectively raise capital through the public markets.

ADISA would be happy to further discuss our concerns and continue to assist in creating appropriate protections for investors in the industry.

Sincerely,

John H. Grady
President

cc: Catherine Bowman, Legislative & Regulatory Committee Chair

Drafting Committee:

Deborah S. Froling

Ellenoff Grossman & Schole LLP

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July 14, 2017

Via email – pubcom@finra.org

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 17-15

Dear Ms. Mitchell:

Thank you for the opportunity to comment on the proposed revisions to Rule 5110 in FINRA Regulatory Notice 17-15. We agree with and appreciate many of the changes FINRA has put forth. There is one significant issue we call to your attention and a couple of other comments we present for your consideration below.

Revisions to the valuation method for options, warrants and other convertible securities

We encourage FINRA to reconsider the change to the valuation method presented in Supplementary Material .02 to Rule 5110 for options, warrants and other convertible securities received as underwriting compensation to entertain "alternate securities valuation method[s] that [are] commercially available and appropriate for the type of securities to be valued". FINRA should continue to use a single valuation method applied to all transactions in order to process filings in a consistent, predictable and efficient manner. Our concerns are twofold:

1. Varying methods will yield inconsistent results from dealer to dealer and deal to deal.
2. Assessment of a new valuation method during the pendency of a Public Offering System filing will delay resolution of that filing and will divert Department staff time and attention from other filings.

In lieu of the proposed revision to Rule 5110, we encourage the Department to consider issuing an invitation for filers to submit alternative valuation methods with a discussion of the advantages and disadvantages of each. The Department can consider and test the options presented and select one as the new standard or determine to continue with the method currently in place. We note that the Black-Sholes method requires a volatility component of the stock in its calculation. This element could drastically change as the review process moves forward, especially an S-1 offering that could take a couple of months to clear. Any factor that could potentially overvalue the worth of the warrants would limit the ability of the member firms to include warrants as an Item of Value for compensation. Please bear in mind that a method prone to overvaluing warrants would have a significant and disproportionate negative impact on member firms that work with smaller issuers because these companies have often have limited cash resources and rely more heavily on granting non-cash fees.

We urge FINRA to retain the current formula pending selection of a new valuation method, so that filers and member firms have certainty that filings will be processed in accordance with long-established expectations. In the absence of any demonstrated abuses (and we note that none were cited in the proposed revision), there is no impetus to change the formula for the sake of change.

Additional suggestions/requests

Corporate Financing Department Guidance

We request FINRA to enhance its Rule 5110 FAQs and publish informal interpretations to more broadly and frequently circulate guidance provided to counsel and members. Some of the Corporate Financing Department's prior informal guidance has been reflected in the proposed revisions to Rule 5110, but future policy changes or guidance will not be and should be uniformly available to all filers and member firms.

Compensation Guidelines

We respectfully request FINRA to revisit general guidelines on what constitutes "unreasonable" compensation. Particularly for smaller offerings, this standard is a source of confusion, delay and tension between the Department, members and counsel. As demonstrated by FINRA's elimination of the 8% cap on shelf takedowns, not all offerings will migrate to the greatest compensation value for a given offering size, type and level of risk for the member firm. Most offerings will be driven by market conditions. The current presumption in favor of an 8% cap on shelf takedowns provides a useful measure for firms and still affords both FINRA and member firms leeway to address the factors present for a given offering. We encourage FINRA to consider updating the information in Notice to Members 92-53 to provide current guidelines.

Thank you again for the opportunity to submit comments. If you have any questions, please contact Joan Adler at 212-370-1300.

Sincerely,

Ellenoff Grossman & Schole LLP

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July 7, 2017

VIA ELECTRONIC MAIL

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

Re: FINRA Regulatory Notice 17-15
Corporate Financing: FINRA Requests Comment on Proposed Amendments to the FINRA Corporate Financing Rule

Dear Ms. Mitchell:

We are submitting this letter on behalf of our client, the Committee of Annuity Insurers (the "Committee"),[1] in response to Regulatory Notice 17-15, *Corporate Financing: FINRA Requests Comment on Proposed Amendments to the FINRA Corporate Financing Rule* (the "Notice"), issued by the Financial Industry Regulatory Authority, Inc. ("FINRA") on April 11, 2017.[2] The Notice solicits comments on proposed amendments, subsequently revised on May 24, 2017 ("Proposed Amendments"),[3] to FINRA Rule 5110 (the "Corporate Financing Rule"), as well as related Rule 5121 (the "QIU Rule"), which were developed as a result of a comprehensive review launched in April 2014.

BACKGROUND

The Corporate Financing Rule and the QIU Rule are of interest to Committee members because of the exemptions provided by the rules for certain types of insurance contracts issued by Committee members that are distributed by FINRA members. More particularly, since its adoption in 1970, the Corporate Financing Rule has provided exemptions for variable contracts,[4] and group annuity contracts purchased by qualified plans ("exempted group contracts"),[5] and

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[1] The Committee was formed in 1982 to address legislative and regulatory issues relevant to the annuity industry and to participate in the development of securities, banking, and tax policies regarding annuities. For three decades, the Committee has played a prominent role in shaping government and regulatory policies with respect to annuities, working with and advocating before the SEC, CFTC, FINRA, IRS, Treasury, Department of Labor, as well as the NAIC and relevant Congressional committees. Today the Committee is a coalition of many of the largest and most prominent issuers of annuity contracts. The Committee's member companies represent more than 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.
[2] The Notice is posted at http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-15.pdf.
[3] The revisions to the initial version of the Proposed Amendments expanded the exemption in proposed paragraph (g)(2) to apply to the QIU Rule as well as the Corporate Financing Rule. The Proposed Amendments are accessible at http://www.finra.org/industry/notices/17-15.
[4] See FINRA Rule 5110(b)(8)(D), which exempts variable contracts as defined in FINRA Rule 2320(b)(2).
[5] See FINRA Rule 5110(b)(8)(B), which exempts securities that are defined as "exempt securities" in Section 3(a)(12) of the Securities Exchange Act of 1934, as amended, which in turn includes any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with certain qualified plans.

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since 1995 has also exempted market value adjusted insurance contracts ("MVA contracts").[6] These exemptions are currently provided by paragraph (b)(8) of the Corporate Financing Rule. Moreover, the introductory text for that paragraph also provides an exemption from the QIU Rule. While the QIU Rule itself contains a few exemptions of relevance to variable contracts and exempted group contracts, the exemptions do not encompass MVA contracts. Consequently, broker-dealer member firms participating in public offerings of MVA contracts historically have relied on the exemption from the QIU Rule provided by paragraph (b)(8) of the Corporate Financing Rule.

PROPOSED AMENDMENTS

The Proposed Amendments would substantially revise the Corporate Financing Rule with the intention of modernizing and simplifying its provisions, including revisions to filing requirements and exemptions, disclosure requirements, organization and terminology ("Revised Corporate Financing Rule"). Most relevant to the Committee, the Revised Corporate Financing Rule would retain the existing exemptions for variable contracts, exempted group contracts and MVA contracts (together, "Existing Exemptions"), relocated to paragraph (g)(2), and add a new exemption for "any insurance contracts not otherwise included" in the Revised Corporate Financing Rule (the "Other Contracts Exemption").[7] MVA contracts and insurance contracts qualifying for the Other Contracts Exemption thus would be exempt from the filing requirements and substantive regulation of the Revised Corporate Financing Rule, as well as from the QIU Rule, under paragraph (g)(2) of the Corporate Financing Rule. With regard to the QIU Rule, the Proposed Amendments would not make any change relevant to insurance contracts.

COMMITTEE COMMENTS

The Committee appreciates the opportunity to submit comments in response to the Notice. The Committee is very pleased that FINRA is proposing to add the Other Contracts Exemption to the Revised Corporate Financing Rule and fully supports the inclusion of the Other Contracts Exemption. Further, the Committee urges FINRA to pursue the addition of the Other Contracts Exemption regardless of whether FINRA proceeds with the other changes contemplated by the Proposed Amendments.

The Committee has been active for some time in proposing revisions to the Corporate Financing Rule to encompass other types of contracts developed by Committee members that are registered with the Securities and Exchange Commission (the "SEC") and may not qualify for the Existing Exemptions, such as SEC-registered indexed annuities and contingent deferred annuities. As insurance companies have introduced new types of insurance contracts, member firms have had to consider whether to pursue individual exemptions or interpretive relief to confirm that neither the Corporate Financing Rule nor the QIU Rule applies to the offerings of those insurance contracts. The Proposed Amendments would substantially resolve these critical questions faced by Committee members and other member firms regarding the status of such insurance contracts under FINRA rules.

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[6] See FINRA Rule 5110(b)(8)(E), which describes MVA contracts as deferred annuity contracts or life insurance policies the value of which are guaranteed if held for specific periods, and the nonforfeiture value of which are based upon a market value adjustment formula for withdrawals made before the end of any specified period.
[7] Proposed FINRA Rule 5110(g)(2)(I).

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CONCLUSION

The Committee appreciates the opportunity to provide these comments on the Notice. Please do not hesitate to contact Susan Krawczyk (202.383.0197 or SusanKrawczyk@eversheds-sutherland.com) or Clifford Kirsch (212.389.5052 or CliffordKirsch@eversheds-sutherland.com), if you have any questions regarding these comments.

Respectfully submitted,

EVERSHEDS SUTHERLAND (US) LLP

BY: Susan Krawczyk
Susan Krawczyk

BY: Clifford Kirsch BMA
Clifford Kirsch

FOR THE COMMITTEE OF ANNUITY INSURERS

EVERSHEDS SUTHERLAND

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Life and Annuity Companies
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Lincoln Financial Group
MassMutual Financial Group
Metropolitan Life Insurance Company
National Life Group
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Symetra Financial Corporation
The Transamerica companies
TIAA
USAA Life Insurance Company
Voya Financial, Inc.

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July 13, 2017

Submitted via email to: pubcom@finra.org

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, N.W. Washington, D.C. 20006-1506

Re: Regulatory Notice 17-15:
<u>Proposed Amendments to the FINRA Corporate Financing Rule</u>

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") in response to the request for comments by the Financial Industry Regulatory Authority, Inc. ("FINRA") pursuant to FINRA Regulatory Notice 17-15 (the "Notice"), as more fully set forth below.

This letter was prepared by members of the Committee's Subcommittee on FINRA Corporate Financing Rules. The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors, and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

I. Description of the Proposal

FINRA Rule 5110 (commonly known as the Corporate Financing Rule) is the principal FINRA rule regulating compensation received by underwriters participating in public offerings of securities. FINRA Rule 5110 prohibits FINRA member firms and their associated persons from participating in a public offering of securities if the underwriting terms and conditions, including the amount of compensation to be received, are unfair or unreasonable. The Corporate Financing Rule received its last substantial update in 2004 and was the subject of limited revisions to the section of the rule governing "prohibited arrangements" as recently as 2014 ("Current Rule 5110"). With the proposed changes described in the Notice ("Proposed Rule 5110"), FINRA seeks to modernize the Corporate Financing Rule while retaining its core purpose of ensuring that all underwriting compensation received by participating FINRA member firms in connection with a public offering of securities is fair and reasonable.

The Committee strongly supports FINRA's efforts to modernize and streamline the Corporate Financing Rule and believes the proposed changes will be welcomed by member firms. Nonetheless, room for improvement remains in various sections of Proposed Rule 5110, as discussed in our comments below.

II. Selected Proposed Changes in Proposed Rule 5110

A. Filing Requirements

1. Proposed Rule 5110(a)(3) – Timely Filing Requirements

The Committee commends FINRA's proposal to extend the required filing period from one to three business days following the filing of documents with the Securities and Exchange Commission (the "SEC") and agrees that this change should reduce instances of inadvertent late filings. However, we believe FINRA should retain the current reference to reliance on filings made by issuers in Proposed Rule 5110(a)(3)(B) such that a member firm would not be required to make a separate filing if such filing has already been made by the issuer. For example, issuers, through the assistance of counsel, regularly file shelf registration statements subject to the Current Rule 5110 filing requirements prior to engaging underwriters for a specific offering in order to better manage the timing of the review process. Although Footnote 8 to the Notice discusses such situations, we believe a specific reference in Proposed Rule 5110 would be helpful. Alternatively, rather than including the specific reference in Proposed Rule 5110(a)(3)(B), FINRA could clarify the availability of such reliance in the Supplementary Material.

2. Proposed Rule 5110(a)(4) – Documents and Information Required to be Filed

(i) **Proposed Rule 5110(a)(4)(A)(ii).** The Committee supports the modification in Proposed Rule 5110 that codifies current guidance that standard industry forms, such as the agreement among underwriters, are not required to be filed with FINRA in connection with an offering.

(ii) **Proposed Rule 5110(a)(4)(A)(iii).** Proposed Rule 5110 would require the filing of marked pages only when "changes to the offering and the underwriting terms and arrangements" are contained in an amendment to the registration statement. We appreciate that Proposed Rule 5110 seeks to limit the number of additional filings required in connection with each offering, and while this modification is helpful for certain types of "exhibit only" filings and amendments to update financial statements, as a practical matter, the inclusion of the broad reference to "changes to the offering" will limit the utility of this provision. Thus, we recommend that FINRA modify this proposed revision to delete the reference to changes "to the offering" and instead narrow the requirement to focus on "changes relating to the disclosures made or to be made in any filing pursuant to Rule 5110 that impact the underwriting terms and arrangements for the offering." In doing so, an additional FINRA filing including marked pages would be required only when the SEC filing contains changes that affect the "underwriting terms and arrangements." We believe this revision would appropriately capture the documents relevant to FINRA's review in this context and would alleviate the burden on member firms (and associated time and cost) to make unnecessary administrative filings.

(iii) **Proposed Rule 5110(a)(4)(B)(iv).** The Committee supports FINRA's decision to eliminate the current representation required to be made by participating members with respect to any association or affiliation with holders of unregistered equity securities acquired during the review period and to limit the required representation with respect to a participating member's association or affiliation with any 5% beneficial owner of the issuer's securities to include only the ownership of any class of the issuer's "equity or equity-linked securities". However, the Committee requests that FINRA provide additional guidance with respect to this requirement where beneficial owners of 5% or more of any class of the issuer's equity securities are funds or other types of investment vehicles, which are usually in the form of limited partnerships or limited liability companies. In such cases, the Committee requests that FINRA limit the requirement to include a statement of association or affiliation only with respect to the general partner or investment manager of such fund or investment vehicle, and any limited partner beneficially owning more than 25% of the limited partnership or limited liability company membership interests of the fund or investment vehicle.

(iv) **Proposed Rule 5110(a)(4)(C).** Proposed Rule 5110 adds a new requirement for member firms to file a written notification to FINRA with respect to any underwriting compensation received by a participating member in connection with an offering that was filed with FINRA but that was ultimately not completed according to its terms. Any agreement governing such arrangement would also be required to be filed (presumably, to the extent it has not already been filed pursuant to Proposed Rule 5110(a)(4)(A)(ii)). The Committee notes that if such compensation is received for services actually rendered and/or for out-of-pocket expenses actually incurred in connection with such failed offering in compliance with the requirements of Proposed Rule 5110(f)(4), it is incongruous to treat such payments as underwriting compensation received in connection with a subsequent successful offering. In addition, the Committee believes that the lack of an endpoint for the notification requirement will almost certainly result in confusion and needless violations. We note that issuers may indefinitely suspend the SEC review of their offerings after an initial registration statement is filed with or submitted confidentially to the SEC and when such a suspension results in a protracted delay or the offering is abandoned indefinitely, it is unclear when the underwriters' obligation to make the notification would be triggered. Therefore, if FINRA believes that this new filing obligation is necessary, the Committee requests that FINRA clarify the purpose of the obligation, confirm that any such payments are tied to the original failed offering and not a subsequent successful offering, and provide a sunset provision for the requirement.

B. Underwriting Compensation

1. Proposed Rule 5110(c) – Securities Acquisitions Not Considered Underwriting Compensation

The Committee generally supports FINRA's revisions to the so-called "Venture Capital Exceptions" from underwriting compensation for securities received by participating members or their affiliates in connection with an issuer's private placements or lending arrangements, particularly with respect to the adjustments to the percentage limits for such acquisitions. However, the Committee encourages FINRA to reconsider the proposed revisions to include the following:

(i) **Timing.** Expand the timing requirement of the Venture Capital Exceptions to allow for application to situations in which the participating member or its affiliate has made its investment in the issuer <u>after</u> the required filing date. The timing restriction, as currently drafted, is a significant detriment to capital formation and is particularly an issue in public offerings that have been substantially delayed and where the issuer is most in need of an infusion of capital. It may also unfairly impact a member firm if it or an affiliate participates in a private offering by the issuer without knowing that the issuer had previously confidentially submitted a registration statement to the SEC and is later invited to join the underwriting syndicate. Furthermore, where all other criteria for any one of the Venture Capital Exceptions is met, the participating member or its affiliate is not preferenced with respect to the other investors by virtue of the fact that the subject transaction occurs subsequent to the initial filing date for the offering.

(ii) **Price and Terms.** In order to meet each of the Venture Capital Exceptions, the participating member must acquire the issuer's securities "at the same price and with the same terms as securities purchased by all other investors." The Committee suggests that this clause be revised such that the participating member may acquire its securities "on no better terms" than the other investors. The Committee notes that member firms may choose to forego voting rights or other indicia of control when purchasing an issuer's securities and such a (detrimental) variation in the purchase terms should not deny a participating member the ability to rely on one of these exceptions.

(iii) **Proposed Rule 5110(c)(1)(B).** The Committee requests that FINRA revise Proposed Rule 5110(c)(1)(B) to read "investment or loan" instead of "investment and loan" in order to make clear that this provision does not require a participating member or its affiliate to make both an investment in and a loan to the issuer in order to rely on the exception.

2. **Supplementary Material .01(a)(3) – Reimbursement of Fees and Expenses of Counsel**

Supplementary Material .01 includes "fees and expenses of counsel to participating members (except for reimbursement of "blue sky" fees)" as "underwriting compensation" related to a public offering. The Committee requests that FINRA clarify that fees and expenses of counsel to the underwriters would only be deemed to be underwriting compensation to the extent that such fees are actually paid by or on behalf of the issuer and reimbursement is actually received by a FINRA member.

3. **Proposed Supplementary Materials .01(b) – Payments That Are Not Deemed To Be Underwriting Compensation**

The Committee requests that FINRA expand the list of payments that are not deemed to be underwriting compensation as follows:

(i) **Bankruptcy Proceedings.** The addition of an exemption for securities acquired by a participating member in connection with a court-approved bankruptcy process.

(ii) **Supplementary Materials .01(b)(11).** The expansion of the exemption for "listed securities purchased in public market transactions" to include the acquisition of "securities that are not deemed restricted securities under Securities Act Rule 144(a)(3)."

4. **Proposed Supplementary Material .01(b)(12) – Exemption for Securities Acquired as a Result of an Employee Plan**

The Committee supports the expansion of the exclusion for securities received as a result of certain employee benefit plans, but recommends that the exception from underwriting compensation for securities received "through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code (the "IRC") *or a similar plan*" be clarified to specifically include securities received under a written compensatory benefit plan in an offering exempt from registration pursuant to Rule 701 under the Securities Act of 1933 (the "Securities Act"). As with IRC Section 401 qualified plans, grants by issuers pursuant to Securities Act Rule 701 plans are for the purpose of compensating employees and are wholly unrelated to any underwriting compensation in connection with a public offering. Furthermore, the need to obtain and review diligence questionnaires from each person who has received securities from the issuer pursuant to such a plan during the review period for an offering in order to confirm that no grant was made to an associated person of an underwriter is extremely burdensome, especially when an offering has been delayed by the issuer and the relevant review period is lengthy. Expressly including Securities Act Rule 701 plans would be in accord with the expanded exemption to "similar plans" in Proposed Rule 5110 and would minimize any interpretive confusion. Moreover, as the reference to "similar

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plans" might itself lead to confusion and interpretive questions, we recommend that FINRA also expressly include within the exemption any other "employee benefit plan (as such term is defined in Securities Act Rule 405)."

C. Proposed Rule 5110(d) – Lock-Up Restrictions

The Committee commends FINRA for revising the lock-up restrictions under Proposed Rule 5110(d)(1) to clarify that the 180-day restricted period begins with the date of commencement of sales in the public offering and to minimize the impact of the lock-up restrictions by including some important additional exemptions. However, we note that, as revised, the lock-up restrictions of Proposed Rule 5110 would also potentially expand the current provision in certain respects. In particular, the application of the current provision is limited to "public equity offerings" rather than all offerings and covers only equity securities received in transactions that are not registered with the SEC.

The Committee requests additional clarification and FINRA's rationale for this proposed change, as it does not appear to us to serve any investor protection motive. In addition, the Committee asks FINRA to provide further guidance with respect to whether it is intended that the lock-up restriction would prevent participating members from selling securities acquired as underwriting compensation in the public offering itself. If that is, in fact, the intent, we would like to understand why FINRA believes such a limitation is necessary given that any such sale would require appropriate disclosure and utilization of a qualified independent underwriter ("QIU") if applicable under FINRA Rule 5121, which would appear to address any issuer or investor protection concerns.

D. Proposed Rule 5110(e) – Non-Cash Compensation

The Committee notes that FINRA has determined to delay addressing the provisions covering the receipt by member firms of non-cash compensation pending a separate consolidated review of the non-cash compensation rules generally. However, the Committee believes that the provisions of Current Rule 5110, as included in Proposed Rule 5110, governing the receipt any non-cash compensation require more immediate attention. If applied literally, the non-cash compensation provisions state that members may not receive any non-cash compensation other than those limited items set forth in the provision itself, and those items do not include certain forms of non-cash consideration such as securities, derivative instruments or rights of first refusal that are expressly permitted elsewhere in the rule. We believe that such an inherent conflict should not be deferred, but instead should be addressed in the Proposed Rule 5110 amendments.

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E. Exemptions from the Filing and/or Rule Compliance Requirements

1. Proposed Rule 5110(g)(1) and FINRA Rule 5121(a)(2) – Issuers Required to File with FINRA due to the Required Participation of a Qualified Independent Underwriter

The Committee requests that FINRA reconsider its requirement that registration statements relating to offerings that would otherwise meet an exemption from the filing requirements pursuant to Proposed Rule 5110(g)(1) be filed with FINRA solely because an offering requires the engagement of a QIU pursuant to FINRA Rule 5121(a)(2). This requirement is outdated because FINRA no longer requires member firms to register to act as a QIU and, instead, relies on each member firm to confirm that it meets the QIU requirements in connection with a particular offering. Accordingly, as a practical matter, FINRA is not engaged in a review of whether the member firm meets the QIU requirements. Moreover, FINRA Rule 5121 requires prominent disclosure of all conflicts of interest as well as QIU arrangements in the prospectus supplement for the related offering. Finally, we note that this requirement regularly causes issuers, which are otherwise exempt from the Current Rule 5110 filing requirements (see discussion of the "experienced issuer" exemption below), to file and pay a filing fee for the aggregate dollar amount of securities originally registered on a shelf registration statement in connection with a single take-down requiring QIU participation, even if only a limited number of securities registered on the registration statement remain unsold or the registration statement is nearing its three-year expiration at the time of the offering. Accordingly, the Committee believes that this filing requirement is unduly burdensome on capital formation, serves no investor protection role and should be removed from Proposed Rule 5110(g)(1).

2. Proposed Rule 5110(g)(1)(C) and (i)(6) – Experienced Issuer Exemption

The Committee appreciates the attempt to streamline the exemption for offerings by issuers that meet the so-called "pre-1992" requirements for filing registration statements on Forms S-3, F-3 and F-10 by incorporating the historical reporting and public float criteria required at that time into the new defined term "experienced issuer".[1] Including the criteria for the exemption directly in the rule effectively eliminates the need for participating members to consult Notice to Members 93-88 (issued November 1993) and nearly 25-year old registration statement forms just to determine applicable eligibility thresholds.[2] However, while simpler on its face, the new definition does not

[1] An experienced issuer is an entity with 36 calendar months reporting history preceding the filing of the registration statement and either (i) a minimum of $150 million aggregate market value of voting stock held by non-affiliates or (ii) a minimum of $100 million aggregate market value of voting stock held by non-affiliates and a minimum annual trading volume of such stock of three million shares (mirroring the thresholds for eligibility to file on SEC Form S-3 that existed prior to October 21, 1992).

[2] *See, e.g.*, FINRA (then NASD) Notice to Members 93-88, available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1551.

benefit from related SEC and FINRA interpretive guidance, including guidance published as part of Notice to Members 93-88. Therefore, the Committee believes that this approach will lead to additional confusion, interpretive questions and calculation issues when determining whether issuers can rely on this exemption.

More fundamentally, however, the Committee believes that even the proposed criteria is outdated and no longer appropriate. Instead, an exemption from the FINRA filing requirement should be available to any issuer that is eligible to file a registration statement under the SEC's current requirements for such forms. Currently, issuers that do not meet the "pre-1992" exemption are required to file both the base prospectus and all related prospectus supplements relating to any takedown offerings (or just the base prospectus for well-known seasoned issuers ("WKSIs")), which, after receiving "immediate clearance," are subject to potential post-offering review. If all offerings, filed or not, are subject to the same post-offering review, the Committee questions the value to issuers and investors of this filing requirement. Furthermore, the Committee is concerned that this requirement disproportionately burdens issuers most in need of capital, including younger, smaller issuers. Finally, with respect to WKSI issuers, the Committee finds FINRA's continued retention of the requirement for WKSIs to file base prospectuses unsupportable because (i) FINRA does not review base prospectuses and (ii) Proposed Rule 5110 does not provide for any required disclosure regarding underwriting compensation in the base prospectus.

If, however, FINRA believes that limiting the exemption beyond the current requirements for Forms S-3, F-3 and F-10 is necessary for the protection of investors, the Committee requests that FINRA consider revising the experienced issuer definition to also cover issuers with a 12 month reporting history if they have (i) a public float of at least $75 million and (ii) an average daily trading volume (as defined by Regulation M) in their common equity securities of at least $1 million. The Committee also requests that FINRA include issuers that meet these criteria that are filing on Form N-2 as eligible for this exemption.

3. Proposed Rule 5110(g)(1)(E) – Exchange Offers

The Committee requests that FINRA revise the exemption from the filing requirements for exchange offers to include situations where the securities to be acquired in the exchange are convertible into securities that are "listed on a national securities exchange as defined in Section 6 of the Exchange Act." Furthermore, the Committee notes that, in many cases, the role played by FINRA members acting as distribution managers in connection with an exchange offer is limited to contacting investors and recording their intention to tender, as indicated by the nominal compensation received for such services. Accordingly, we request that FINRA consider exempting from the filing requirements exchange offers where the compensation to be received by the distribution manager does not exceed 2% of the registered aggregate dollar amount of the offering and no FINRA member acts as an underwriter for the securities.

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4. Proposed Rule 5110(g)(1)(H) – Exemption from the Filing Requirements for Offerings by "Closed-End" Investment Companies that are Operated as "Tender Offer Funds"

Proposed Rule 5110 includes a new exemption from the filing requirements for certain offerings by "tender offer funds." The exemption is limited to follow on offerings by such issuers only if such issuer has previously filed its initial public offering with FINRA. FINRA's stated rationale in the Notice with respect to this exemption is that such offerings are adequately covered by the requirements of FINRA Rule 2341 and the Investment Company Act of 1940, as amended. The Committee notes that the same rationale should cover initial public offerings by such entities. In practice, FINRA has agreed that the underwriting limits of such issuer's offerings should be governed by FINRA Rule 2341, but has required a formal exemption request process for an offering specific exemption from the requirements for Current Rule 5110. This approach is unduly burdensome on member firms. Therefore, if FINRA intends to continue to require the filing of initial public offerings by such issuers under Proposed Rule 5110, the Committee requests that FINRA clarify in Proposed Rule 5110 that the underwriting terms and arrangements for such offerings, while subject to the filing requirements of the Rule, will be reviewed for compliance with the requirements of FINRA Rule 2341.

5. Proposed Rule 5110(g)(2)(L) – Public Utility Holding Company Act Exemption

The Committee requests clarification as to whether the exemption from the filing and rule compliance requirements of Proposed Rule 5110 for "securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act" remains tied to the requirements of the Public Utility Holding Company Act, which was repealed effective 2005 and replaced by the Energy Policy Act of 2005.

F. Proposed Rule 5110(h) – FINRA Rule 9600 Exemption Requests

The Committee notes that as revised in Proposed Rule 5110, a request for an exemption "from any or all of the provisions of this Rule that [FINRA] deems appropriate" may be granted "in exceptional and unusual circumstances, taking into consideration all relevant factors." In contrast, under Current Rule 5110, FINRA may grant an exemption "for good cause shown" where such grant would be "consistent with the purposes of the Rule, the protection of investors, and the public interest." The Committee questions whether this revision is intended to signal a change to the standard of review for exemption requests, and if so would like to understand the rationale for such a change. First, the Committee believes that the reasons for granting such an exemption should not be tied to the rarity of the situation, but rather its merits. Second, the Committee believes that this change in terminology represents a marked decrease in clarity compared with the more fully elucidated standard of review under Current Rule 5110. This lack of clarity could lead to inconsistent and potentially arbitrary results.

G. Proposed Rule 5110(i) – Definitions

1. Proposed Rule 5110(i)(2) – Bank

Proposed Rule 5110 helpfully expands and clarifies the exemption from the filing requirements for issuers with outstanding investment grade-rated debt (other than in respect of the issuer's initial public equity offering) to expressly include banks.[3] However, while Proposed Rule 5110(i)(2) provides that the term "bank" – for purposes of paragraph (c) of the Rule – includes only the regulated entity and paragraph (c) limits the exemption for banks to those entities defined pursuant to Section 3(a)(6) of the Exchange Act for the purposes of the exception from underwriting compensation under Proposed Rule 5110(c)(1)(A), the term "bank" is not defined for purposes of the exemption for banks under Proposed Rule 5110(g)(1). As the purpose of the filing exemption is to exempt offerings by issuers of investment grade-rated debt, such exemption should not be limited to Section 3(a)(6) banks, which definition is largely limited to U.S. domiciled banks and U.S.-based branches of non-U.S. banks. Accordingly, the Committee believes that the exemption unintentionally excludes non-U.S. bank issuers. The Committee requests that FINRA further clarify this exemption to expressly include non-U.S. banks either by including a new definition of bank or by adding further clarification to the exemption for issuers with outstanding investment grade-rated debt.

2. Proposed Rule 5110(i)(15) – Participating Member

The Committee agrees with FINRA that the term "participating member" should not include the "issuer," but suggests that the definition be modified as follows to clarify this intent: "The term 'participating member' means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family thereof, but does not include the issuer."

3. Proposed Rule 5110(i)(18) – Public Offering

Proposed Rule 5110(i)(18) would define a public offering as "any primary or secondary offering of securities made pursuant to a registration statement, offering circular or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition." FINRA stated that adding the definition to Proposed Rule 5110 would allow it to delete the corresponding definition from FINRA Rule 5121[4] and incorporate all of the Proposed Rule 5110 definitions into FINRA Rule 5121 by reference.

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3 *See* Proposed Rule 5110(g)(1)(A). In this regard, we also suggest that FINRA further clarify this exemption from the filing requirements by revising it to also include (in addition to "corporations") issuers that are limited liability companies, limited partnerships, business trusts or other legal persons.

4 FINRA has included this definitional change to FINRA Rule 5121 in the proposed amended rule language included in Attachments A and B to the Notice.

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First, the Committee recommends that FINRA consider revising the definition to clarify that a public offering is "any primary or secondary distribution of securities made in whole or in part in the United States to the public," which the Committee believes avoids circularity and more accurately reflects the types of offerings intended to be covered by Proposed Rule 5110.

Second, we note that in transferring the definition of public offering from FINRA Rule 5121 to Proposed Rule 5110, FINRA has removed from the definition the clarifying exclusions for offerings of exempted securities as defined in Section 3(a)(12) of the Securities Exchange Act of 1934 (the "Exchange Act") and offerings made pursuant to (i) Securities Act Sections 4(a)(1), 4(a)(2), or 4(a)(6), (ii) Securities Act Rules 504 (if the securities are "restricted securities" under Securities Act Rule 144(a)(3)), 505[5] and 506, and (iii) Securities Act Rule 144A or SEC Regulation S, and has instead included these types of offerings in the list of offerings not subject to this Rule and FINRA Rules 2310 and 5121 under paragraph (g)(2). The Committee believes that the original formulation of the definition currently included in FINRA Rule 5121 is the clearer and more direct approach. As proposed, the participating member would, for example, be required to treat private placements and Regulation S offerings as "public offerings" but ones that are then exempted from the filing and compliance requirements of Proposed Rule 5110 and the compliance requirements of FINRA Rules 2310 and 5121, which is likely to lead to unnecessary confusion and interpretive issues. Therefore, the Committee requests that FINRA return to the current formulation of including the exemptions for these types of offerings within the definition of public offering when it moves the definition from FINRA Rule 5121 to Proposed Rule 5110. While the addition of the reference to "distributions" made "in whole or in part in the United States to the public" (as we propose in the immediately preceding paragraph) should help clarify the issue, we continue to believe the inclusion of the specified exclusions remains important to reduce interpretive questions. In addition, the Committee believes that the list of offering types that do not constitute a "public offering" should also expressly include offers and sales of securities pursuant to Sections 4(a)(3) and 4(a)(4) of the Securities Act and that the reference in Proposed Rule 5110(i)(18) to "Section 4(a)(6)" should instead refer to "Section 4(a)(5)."[6]

4. Proposed Rule 5110(i)(20) -- Review Period

The Committee supports the addition of the new definition clarifying and codifying the review periods essential for determining which payments, rights, interests or other benefits are required to be included as underwriting compensation for an offering. In particular, the Committee appreciates the express inclusion of durations that vary depending on the type of offering. We note that Proposed Rule 5110 clarifies the

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[5] Securities Act Rule 505 was repealed effective May 22, 2017. *See* SEC release No. 33-10238 (Oct. 26, 2016).

[6] We note that former Section 4(6) of the Securities Act (which is referred to in the FINRA Rule 5121 definition of public offering) was redesignated as Section 4(a)(5) in connection with the adoption and implementation of the Jumpstart Our Business Startups Act of 2012.

understanding that the review period for either a firm commitment or a best efforts takedown offering under a shelf registration statement begins 180 days prior to the required filing date of the takedown and continues through to the 60th day following the final closing of the same takedown. However, the Committee requests additional guidance from FINRA with respect to when the review period would end for offerings with an indeterminate time period such as at-the-market offerings, which may continue for several years. The Committee also questions why FINRA has chosen to limit the review period specified in Proposed Rule 5110(i)(20)(C) to "firm commitment or best efforts takedown or any other continuous offering on behalf of *securityholders...*" and requests that FINRA revise this definition to include the issuer. As currently proposed, the reference to "on behalf of selling securityholders" appears to qualify "firm commitment", "best efforts" and "other continuous offering" for the purpose of the review period definition, which we do not believe was intended.

H. FINRA Rule 5121 -- Public Offerings of Securities With Conflicts of Interest

Given the inter-relationship between FINRA Rules 5110 and 5121, FINRA's inclusion of the full text of FINRA Rule 5121 in the Notice, and FINRA's request in Regulatory Notice 17-14 for comments on the capital formation rules more generally, the Committee would like to take this opportunity to also comment on certain aspects of FINRA Rule 5121 that we believe unnecessarily impede smooth execution of public offerings.

1. FINRA Rule 5121(a)(1)(A) – "Primarily Responsible for Managing the Public Offering"

The Committee requests that FINRA clarify the meaning of "primarily responsible for managing the public offering" with respect to the conflicts of interest requirements under FINRA Rule 5121, as this reference continues to raise interpretive questions for member firms. We note that appointing a QIU increases the time and expense of a transaction because the issuer must be educated on the topic; a QIU must be identified and, in some cases, added to the transaction at a late stage in the transaction; and additional provisions to the underwriting agreement must be negotiated. The Committee believes that a QIU should be necessary only when *all* the lead managers or bookrunners have a conflict of interest and the offering does not meet the requirements of FINRA Rule 5121(a)(1)(B) or (C).

2. FINRA Rule 5121(f)(3) – Bona Fide Public Market

The Committee requests that FINRA clarify the definition of "bona fide public market". As currently drafted, the definition states that a bona fide public market exists if the issuer of the offered securities has at least one series of securities "traded on a national securities exchange with an Average Daily Trading Volume (as provided by SEC Regulation M) of at least $1 million." However, we understand that the quoted language is intended to be applied consistent with FINRA Rule 5121(a)(1)(B) -- *i.e.*, that the securities being offered in the public offering have a bona fide public market. If this is the correct interpretation, we urge FINRA to take this opportunity to eliminate the continuing confusion as to the proper application of this provision and make appropriate changes to the definition to make the intention clear. Furthermore, the Committee requests that FINRA consider including an exception for offerings of securities convertible into securities meeting the bona fide public market definition for the purposes of FINRA Rule 5121(a)(1)(B).

3. FINRA Rule 5121(f)(6) – Definition of Control

The Committee notes that this definition of control is inconsistent with either the SEC's definition of control or with other FINRA measures of control, primarily because it establishes an unreasonably low control threshold at 10% beneficial ownership. As a result, members and issuers have had to include as "affiliates" for purposes of the FINRA Rule 5121 analysis persons or entities they would not, under ordinary circumstances, consider to be within a "control" relationship. Accordingly, we believe FINRA should revise this definition to use a 25% beneficial ownership threshold, consistent with the definition used for purposes of Form BD.[7]

We also request that FINRA delete the reference in the definition to beneficial ownership of preferred equity as a trigger for control. FINRA made a similar change when it eliminated beneficial ownership of subordinated debt in 2014 and stated that such ownership was "not a meaningful measure of control or affiliation" for purposes of FINRA Rule 5121,[8] which reasoning we believe applies equally to preferred equity.

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7 Form BD defines "control" as: "The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any person that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class of a voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that company."

8 SEC Release No. 34–71372 (Jan. 23, 2014). In this regard, we also note that the definition of "subordinated debt" set forth in FINRA Rule 5121(f)(13) is no longer used in FINRA Rule 5121 or Proposed Rule 5110 and should therefore be deleted.

The Committee greatly appreciates the opportunity to provide its comments with respect to this important rule-making effort and thanks the FINRA staff for its efforts and thoughtful approach to the issues addressed by the proposed amendments. Members of the Drafting Committee are available to meet and discuss these matters with the FINRA staff and to respond to any questions.

Very truly yours,

/s/ David M. Lynn

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July 14, 2017

Re: **FINRA Regulatory Notice 17-15**
Request for Comment on Proposed Amendments to FINRA's Corporate Financing Rule

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

Dear Ms. Mitchell:

We are writing in response to the request for comment in Regulatory Notice 17-15 with respect to proposed amendments to FINRA Rule 5110. While we generally support the amendments, we do not feel they go far enough to accomplish the goals set forth in the notice. Our specific recommendations are below.

Recommendations.

(A) Exemptions from the filing requirements. We believe the following exemptions from the filing requirements of the rule will modernize the rule and lessen burdens on members and issuers.

(1) Exemption from filing for Offerings on Form S-3, F-3 and Certain IPOs

We recommend that the rule be amended to add an exemption from the filing requirements for any offering on Form S-3 or F-3 or any initial public offering (i) of an issuer controlled by a venture capital or private equity fund with $100 million in assets under management or (ii) with proceeds of $75 million or more (collectively, the "Exempted Offerings"). We do not believe staff review of the underwriting terms and arrangements of the Exempted Offerings is necessary because these issuers are sophisticated professional negotiators. In addition, in the case of S-3 and F-3 eligible issuers, investors have immediate access to company disclosure through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators). Accordingly, neither issuer or investor protection should be a concern with respect to the Exempted Offerings. Finally, this exemption will free up FINRA staff to focus on offerings that are more likely to present regulatory problems.

Historical basis for the filing requirements and exemptions. The filing requirements of the Corporate Financing Rule can be traced back to the December 1961 recommendations of the Committee on Underwriting Arrangements of the NASD Board (later called the Corporate Financing Committee) that the Association review underwriting compensation of offerings of unseasoned companies. As they stated, "the Committee will continue to review the offerings of unseasoned companies, the sole test being whether or not, taking into account all elements of compensation and all of the surrounding circumstances, the arrangements as a whole appear unfair and unreasonable..."[1]

The filing requirements under the Corporate Financing Interpretation (the Interpretation), the predecessor to the Corporate Financing Rule, were much more expansive. They originally applied to all public offerings in which members participated in a distributive or advisory capacity, with the exception of straight debt issues rated "B" or better.

In 1983, when the NASD began to consider codifying the Interpretation into a rule, the Corporate Financing Committee recommended that the filing requirements be modified by focusing on the characteristics of the issuer of the securities rather than those of the securities being offered. The Committee observed that underwriting compensation in connection with offerings of equity securities of seasoned issuers seldom approached NASD limitations. They found that "those arrangements are negotiated by sophisticated professional negotiators on the issuer and the investment banker sides. Such negotiations can be expected generally to result in a highly competitive underwriting arrangement."[2] They concluded that NASD review of these arrangements was "extraneous."

The Committee requested that the staff consider a return to the historical approach of limiting corporate financing review to less seasoned issuers. By doing so, they noted that the NASD's resources could be used more efficiently on areas that did need surveillance because they might present regulatory problems.

Consistent with the recommendations of the Corporate Financing Committee, the Corporate Financing Interpretation was amended in 1983 to exempt shelf offerings on Form S-3. The Corporate Financing Rule, which was adopted in 1986, also included exemptions for investment grade rated debt and offerings of issuers with certain investment grade rated debt or preferred stock outstanding.

As stated in NASD Notice to Members 83-12, the shelf exemption "was adopted because it was believed that NASD advance review of these transactions would serve little regulatory purpose" and because "the competitive pressures which come into play in the negotiations preceding the execution of [the underwriting] agreement usually can be relied upon to achieve the overall fairness of the arrangement." The rationale for the exemption was further described in Notice to Members 88-101: "The Committee determined to exempt from the filing requirements securities registered on Form S-3 because an issuer able to satisfy Form S-3's 'registrant requirements' would be followed closely by investors and market professionals. The Committee also felt that the securities markets would efficiently determine a fair price for the securities being offered and that any underwriting compensation received by members ordinarily would be determined under very competitive circumstances."

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[1] NASD Manual (1982) at page 115.

[2] Report to the Subcommittee to Review Filing Requirements (September 20, 1982).

Current analysis of the filing requirements and exemptions. We believe the filing requirements should be reconsidered in view of their historical objectives. As stated above, the Corporate Financing Committee has always taken the position that the review of the underwriting arrangements of offerings of seasoned issuers was unnecessary. Seasoned issuers were defined in the 1980s as registrants "closely followed by investors and market professionals." We believe the determination of what constitutes a seasoned issuer should be reevaluated in view of the significant technological advances since that time.

Today, issuers that are Form S-3 or F-3 eligible may be easily followed by investors and market professionals through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators). They have sufficient bargaining power to ensure that they will not be subjected to unfair or unreasonable underwriting arrangements. In addition, they are likely to be repeat issuers of securities and therefore have future business they will withhold from underwriters unwilling to give them competitive market terms. Review of the underwriting arrangements for these offerings would appear to be extraneous.

Large private equity and venture capital firms have significant negotiating experience and are frequent market participants. They do not need the protection of the Corporate Financing Rule to ensure the fairness of the underwriting terms of the IPOs of issuers they control. We also question whether the rule is needed to protect the issuers of IPOs with proceeds of $75 million or more. Numerous underwriters court issuers for IPOs of this size. This competition ensures that the underwriting terms of such offerings will be fair and reasonable.

(2) Exemption from filing for Shelf Offerings on Forms S-3/F-3/F-10.

Should you decide not to grant the request in item 1 above, we recommend that the proposed exemption from filing for shelf offerings be expanded. The exemption for shelf offerings on Form S-3 in the proposed new rule has been available since March 1983, under the Corporate Financing Interpretation. The exemption went into effect approximately one year after Form S-3 was originally adopted by the SEC. Since that time, the SEC has expanded the eligibility criteria of Forms S-3 and F-3 on two occasions, in 1992 and 2008, in order to permit more companies to cost effectively and expeditiously access capital in the public markets.[3]

In 1992, when the SEC reduced the public float requirement to $75 million under the S-3/F-3 eligibility criteria, the Commission determined that a large majority of the companies that would become eligible to use these forms as a result of this change had securities traded on a national securities exchange or authorized for inclusion on the NASDAQ National Market System and that roughly two-thirds of the companies were followed by at least three research analysts. "This, combined with the success of the 10 year-old integrated disclosure system and shelf registration

[3] In addition, on July 26, 2011, in response to requirements in the Dodd-Frank Act, the SEC amended the transaction eligibility criteria for registering primary offerings of non-convertible debt securities on Form S-3 and F-3. Specifically, they replaced the requirement that the securities be rated investment grade with four alternative provisions. They are that the issuer (i) has issued, for cash, more than $1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years, (ii) has outstanding at least $750 million of non-convertible securities, other than common equity, that were issued through registered primary offerings for cash, (iii) Is a wholly-owned subsidiary of a well-known seasoned issuer (WKSI) as defined under the Securities Act or (iv) is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI.

process, persuaded the SEC that it could extend the benefits of Form S-3 for primary offerings to a larger class of issuers without compromising the investing public's access to sufficient and timely information about such issuers."[4]

The fact that FINRA has not amended the shelf exemption in the Corporate Financing Rule to reflect the revised SEC eligibility criteria makes access to capital more expensive and adds an administrative burden we no longer feel is justified. In 1993 (in NASD Notice to Members 93-88), the NASD committed to "undertake a one-year review of offerings filed with the NASD on registration statement Form S-3...by companies that would not meet the...[eligibility] criteria for Form S-3 [in effect prior to October 21, 1992] to determine whether the market forces related to such offerings result in the presence of fair and reasonable underwriting terms and arrangements." In the absence of a recent study establishing a basis for not expanding the exemption to shelf offerings on current Forms S-3 and F-3, we propose the rule be so modified.

Specifically, we believe the shelf exemption in the new Corporate Financing Rule should be modernized to reflect, at a minimum, the October 21, 1992 S-3/F-3 eligibility requirement of a public float of $75 million (from the $150 million requirement for S-3 issuers and $300 million worldwide public float requirement for F-3 issuers in the current and proposed rule) or better still, to eliminate the public float requirement entirely, in accordance with current S-3/F-3 eligibility criteria. The rationale underlying the public float requirement in Form S-3, as originally adopted, was to protect investors by ensuring that only companies that were widely followed should benefit from short form registration. Similarly, as stated above, the NASD justified the exemption from filing for S-3 shelf issuers on the basis that "an issuer able to satisfy Form S-3's 'registrant requirements' would be followed closely by investors and market professionals...and any underwriting compensation received by members ordinarily would be determined under very competitive circumstances" (Notice to Members 88-101).

The significant technological advances since 1983, in terms of access to company disclosure through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators) permit investors to closely follow any company in which they are interested. Public float is no longer a hallmark of negotiating strength, as is evidenced by the fact that the average underwriting commission on offerings from Form S-3 and F-3 shelf registration statements is just a fraction of what FINRA permits.

Similarly, we believe the requirement in the exemption that the issuer have reported, under the Exchange Act, for three years be modified to one year, as is the case with current Forms S-3 and F-3. When eligibility for these forms required a three year reporting history, investors did not have the ability to access documents incorporated by reference into the registration statement. Now that technology provides investors with immediate access to such information, a three year reporting history does not provide any benefit.

It has been 34 years since the NASD, now FINRA, determined the eligibility criteria for an exemption for shelf filers. In view of the fact that the stated purpose of FINRA's review of the Corporate Financing Rule is to modernize the rule and "reduce administrative and operational burdens," we believe it is appropriate to make the requirements for this exemption consistent with

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[4] Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3, Release No. 33-8812 (June 20, 2007)[72 FR 35118].

the current eligibility criteria of Forms S-3, F-3 and F-10[5]. The competitive nature of negotiations between these issuers and underwriters assures that underwriting terms and arrangements in connection with shelf offerings will be fair and will not compromise issuer or investor protection.

(3) Exemption from filing for WKSI offerings.

While it has been very helpful that FINRA has streamlined the process for qualifying WKSI offerings, we question whether FINRA's goal of investor protection is furthered by the requirement to file such offerings. As you know, FINRA requires very little information to be provided in WKSI filings, reflecting the fact that it is unlikely that the interests of issuers or investors could be compromised in such offerings. The point of the SEC's WKSI initiative was to make access to capital less expensive. We believe this should be FINRA's goal as well.

(4) Exemption from filing for offerings exempt from Rule 5110 but subject to filing under Rule 5121.

We recommend an exemption from filing for offerings that are exempt from filing under the Corporate Financing Rule but subject to filing under the conflict rule. We believe the requirements of Rule 5121 adequately address investor protection concerns and that no additional protection is provided by review of the offering by the Corporate Financing Department. The increase in transaction costs and potential for delay resulting from review are simply not justified. We further note that conflicts are often discovered late in the process leading up to an offering, because, for example, the offering size determined by the market causes the lead underwriter to have a conflict of interest (i.e., it is determined that a lender, affiliated with the lead underwriter, will be repaid more than 5% of the net offering proceeds), at which point the FINRA filing imposes a significant administrative burden.

(5) Exemption from filing for certain convertible debt offerings.

Since the early 1990s, FINRA's Corporate Financing Department has granted exemptions, in response to individual requests, for convertible debt of an issuer that has outstanding investment grade rated debt of the same class as that being offered if there is a bona fide public market in the common stock underlying the debt.

We believe this exemption should be added to the rule or the supplementary material to the rule since any issuer/investor protection concerns for such offerings are fully addressed (i.e., the debt meets the exemption in Rule 5110(b)(7)(B) and the underlying common stock generally meets the exemption in Rule 5110(b)(7)(A)). If FINRA determines that this exemption should only be

[5] The eligibility criteria for Form F-10 in effect on June 21, 1991 required the registrant to have a public float of at least Cdn. $75 million and equity securities with a market value of at least Cdn. $360 million. It also required reconciliation of financial statements to U.S. GAAP. Subsequently, the SEC eliminated the market value requirement from the eligibility criteria and eliminated the GAAP reconciliation requirement at the same time as the SEC eliminated the investment grade security requirement from the S-3/F-3 eligibility requirements for straight debt and preferred stock, (see footnote 3). The SEC eliminated the GAAP reconciliation requirement because of 2011 changes to Canadian regulations requiring Canadian filers to prepare their financial statements pursuant to International Financial Reporting Standards ("IFRS"). It seems odd that FINRA's exemption is conditioned on GAAP reconciliation when Canadian regulations require IFRA financials. In addition, the $75 million public float requirement should be sufficient to assure FINRA that these issuers have sufficient bargaining power to protect themselves from overreaching by underwriters.

granted upon request, the availability of the exemption should be discussed in the rule's Supplementary Material to improve administration of the rule for all members.

(6) Exemption from filing for block trades.

We believe an exemption for block trades should be added to the rule in view of the highly competitive nature of negotiations between issuers and underwriters in connection with these offerings. Such negotiations assure that underwriting terms and arrangements will be fair and will not compromise issuer or investor protection.

(7) Exemption from filing for takedowns from shelf offerings required to be filed.

While it has been helpful that FINRA has, in the past few years, streamlined the process for qualifying shelf offerings, we recommend that FINRA eliminate the requirement to file prospectus supplements and accompanying documents on shelf offerings subject to the filing requirements, given that such documents are largely available on EDGAR. Instead of such filings, FINRA can require that counsel undertake, at the time of filing the shelf registration statement, to obtain representations from members that underwriting compensation will not exceed 8% of gross offering proceeds and that members will not engage in any prohibited arrangements in connection with any takedown from the shelf. This is consistent with FINRA's current practice not to require takedowns to be filed in connection with WKSI offerings.

(8) Exemption from filing for dribble out offerings.

We believe it has been FINRA's longstanding position that no filing is required for shelf offerings registered for the benefit of selling shareholders that are intended to be sold in ordinary market transactions by members acting as agents. It would be helpful for administration of the rule if there were an exemption for these offerings.

(B) Defined terms.

We appreciate the inclusion of new defined terms in the amended rule but believe certain modifications should be made to those definitions.

(1) Underwriting compensation.

(a) "in connection with" vs. "in the review period"

You are proposing to define the term "underwriting compensation" as "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." We believe this definition should be modified to replace the term "in connection with the offering" with "in the review period."

It is necessary that you add "in the review period" to the definition because items of value received by a participating member before the review period are not underwriting compensation. Further, we believe the use of the term "in connection with the offering" is potentially misleading because in this context, it does not necessarily have its literal meaning. For example, if an affiliate of a prospective underwriter purchases securities of an issuer during the review period, those securities are underwriting compensation under the rule, notwithstanding the fact that there may be no connection between the purchase and the public offering. For the same reason, as discussed below, the term "related to the public offering" should be deleted from the proposed rule.

(b) "related to"

To determine whether straight debt or derivative instruments are underwriting compensation, the test in the proposed rule is whether such securities were acquired in a transaction "related to the offering." There is no definition of "related to the offering" and we believe the test in the current rule, which is whether such securities were acquired at a fair price, provides a much more meaningful standard.

In 2004, the Corporate Financing Rule underwent a major revision, one of the purposes of which was to eliminate the need for subjective determinations of whether items of value were acquired "in connection with" or "related to" the offering and provide a more objective standard for members and the Corporate Financing Department to determine what constitutes underwriting compensation. The proposed rule appears to be going back to the pre-existing rubric, which members found to be so inconsistent and troublesome. We believe this is a mistake, particularly if no definition of "related to the offering" is contained in the rule.

We further note that for most of the rule's history, straight debt has not been treated by the Corporate Financing Department as underwriting compensation. We believe that approach should be reflected in the proposed rule. It is difficult to envision a situation in which non-convertible debt could be used as underwriting compensation, unless the interest rate was above the prevailing rate. However, no company seeking to go public would enter into such an arrangement because of its glaring unfairness.

(c) "from any source"

We further request that you modify the definition of underwriting compensation to delete compensation received "from any source." In the alternative, that phrase should be replaced with more limited language. Under the proposed definition, securities acquired, for example, by an affiliate of a member from a former employee of the issuer are deemed underwriting compensation. Regulation of a third party, arms' length sale of securities to an affiliate of an underwriter should be outside the scope of the rule. Regulating such sales does not further issuer or investor protection.

We also recommend that the definition be modified to exclude securities of foreign issuers acquired by participating members in the issuer's domestic market if such market meets certain volume and float requirements. We believe the requirement proposed in the rule (i.e., that the domestic market be a "designated offshore securities market" as defined in Rule 902(b) of Regulation S) is overly restrictive and not meaningful. The real issue is whether the securities are freely trading so that the price paid is the fair market price. For the same reason, the requirement in proposed section (a)(4)(B)(v) should be modified so that participating members need not provide information with regard to securities they acquire during the review period in the issuer's domestic market.

(2) Review period.

Requirement to notify FINRA regarding items of compensation received post-offering.

Because the review period is defined to include the 60 day period following the effective date of a firm commitment offering (or closing or final closing for other offerings), participating members will be required to provide FINRA with information regarding any fees or other compensation received by them, their affiliates, associated persons and immediate family of associated persons for 60 days following the offering. We believe the scope of this requirement imposes a significant diligence burden.

While the Supplementary Material to the proposed rule sets forth examples of payments that are not deemed underwriting compensation (e.g., compensation for commercial banking services as well as brokerage, trust and insurance services to the issuer), the requirement to question every affiliate of an underwriter as to services performed and compensation received during the 60 day post-offering period is unduly burdensome.

(3) Required Filing Date.

We believe the definition of required filing date should be modified with respect to offerings that are dormant for a period of six months or more. Offering delays are often attributable to poor market conditions and cash strapped pre-IPO companies often have to seek private financing from entities that may be participating members, in which case the securities acquired by such members are underwriting compensation. Because the exceptions from underwriting compensation are unavailable for securities acquired by participating members after the first confidential submission to or public filing of the registration statement with the SEC, (whichever is earlier), an issuer may not be able to accept financing from a participating member because of potentially excessive underwriting compensation. This is a terrible result, which we believe FINRA did not intend. Accordingly, either the definition of required filing date should be modified or the exceptions from underwriting compensation should be modified to apply to acquisitions by participating members of the issuer's securities after the required filing date. If the former, we would suggest that the definition provide that with respect to offerings that are dormant for six months or more, the review period begin upon the filing of the first amendment to the registration statement, which has been confidentially or publicly filed with the SEC, following the dormant period.

(4) Institutional Investor.

While the exceptions from underwriting compensation in the existing rule and sections (c)(2) and (c)(3) of the revised rule are, on their face, very helpful and rational from a regulatory perspective, the definition of institutional investor makes these exceptions difficult to impossible to establish. Specifically, a significant diligence burden is caused by the requirement in the definition that the aggregate interest of participating members be less than 5% for a publicly owned entity and 1% for a nonpublic entity. If the entity is a publicly owned corporation, for example, diligence is required with respect to the FINRA affiliation or association of every shareholder of the corporation in order to determine if the 5% threshold is met. With a private limited partnership, the same sort of diligence is required for every limited partner. This is often an impossible burden, which negates the availability of the exceptions from compensation.

(C) Exclusions from underwriting compensation.

(1) Securities issued under compensatory benefit plans or arrangements.

We ask that the exclusion from underwriting compensation for securities acquired pursuant to an employee benefit plan qualified under section 401 of the Internal Revenue Code "or a similar plan" be clarified and expanded. We are making this request because many employee benefit plans or compensatory arrangements of pre-IPO issuers are not qualified under section 401. If you are unwilling to provide an exemption for securities issued to employees and directors under any compensatory arrangement, we ask that you provide an exemption for securities granted or issued under a bona fide benefit plan or compensatory arrangement, as evidenced by the simultaneous grant or issuance to a substantial number of employees or directors that are not participating members or pursuant to the issuer's ordinary course of business (e.g., annual, semi-annual grants or quarterly issuances rather than isolated issuances to a participating member). If you decide to adopt this approach, we recommend that you require a representation from counsel that the grant or issuance is in compliance with the rule rather than requiring FINRA staff to perform this analysis, which is time consuming and may result in delay of the offering. In the alternative, we suggest that securities issued in reliance upon SEC Rule 701 be excluded from compensation. Such a change would reduce the burden of attempting to verify to the Corporate Financing Department that securities issuances or grants of compensation to employees were bona fide and not underwriting compensation.

(2) Securities issued pursuant to court order.

We request that the rule be modified so that securities issued to participating members pursuant to a court order be excluded from underwriting compensation. Such distributions do not require regulation by FINRA as they are not made at the discretion of the issuer.

(3) Fee payments to foreign broker-dealers affiliated with US underwriters.

The rule is unclear as to whether to treat as underwriting compensation fees paid by the issuer to foreign broker-dealers affiliated with participating members for services provided during the review period. We believe cash fees and other compensation paid in connection with the foreign distribution of the offering should not be deemed underwriting compensation.

(D) Lock-up Restrictions.

(1) We believe the expansion of the lock-up restrictions to include straight debt and derivative instruments is not justified and may interfere with some derivative transactions. As stated by NASD former vice chairman Mary Schapiro, "Lock-up requirements may be imposed to bring underwriting compensation into compliance with NASD guidelines and to protect investors in IPOs from the potential for dilution and manipulation if underwriters were to sell large amounts of an IPO issuer's shares into the aftermarket...firms' failure to have policies in place to ensure compliance with the rules and to minimize the opportunity for underwriters and related persons to realize a quick profit from the sale of pre-IPO shares hurt[s] the integrity of the underwriting

process and the confidence of investors."[6] We do not believe these concerns are present in the context of straight debt and derivative instruments acquired as compensation.

(2) We also question the need for extending the lock-up restrictions to underwriting compensation acquired in offerings of debt and derivative instruments. There seems to be no rationale for such expansion and the concerns discussed above do not appear to be present in such offerings.

(E) Clarification of certain matters.

(1) Please provide clarification as to the specific disclosure requirements for securities acquired by participating members that are deemed underwriting compensation. We assume the member(s) that acquired the securities must be named. Are we also required to disclose the class of securities, number of securities and/ or the compensation value of the securities?

(2) Please clarify whether we are required to file information with respect to unvested securities acquired by participating members during the review period. We believe such securities should not constitute underwriting compensation as it is unclear whether the conditions precedent to vesting will ever be satisfied.

(3) Section (a)(4)(A)(iii) of the proposed rule provides that amended documents "containing changes to the offering and underwriting terms and arrangements" are required to be filed. We believe it was FINRA's intention that this provision reduce the number of documents required to be filed. If that is the case, we suggest that the reference to "offering" be deleted, which is appropriate since the Corporate Financing Rule focuses solely on underwriting terms and arrangements. In that connection, we further suggest that the rule be amended to exclude from the filing requirements any exhibit volume containing materials unrelated to the underwriting terms and arrangements. Since the registration statement includes a list of the exhibits, should the Corporate Financing Department be interested in an exhibit that was not filed, it can request the filing of the document in the review process.

(4) The Supplementary Materials provide that fees of independent financial advisers are excluded from underwriting compensation. What about fees paid to members for acting solely as financial advisers?

We appreciate the opportunity to comment on the rule. Should you have any questions regarding the foregoing, please do not hesitate to contact Michael Kaplan at 212-450-4111, Joseph Hall at 212-450-4565, Richard Truesdell at 212-450-4674 or Marcie Goldstein at 212-450-4739.

Sincerely,

Davis Polk & Wardwell LLP

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[6] FINRA News Release, NASD Fines Morgan Stanley $2.7 Million for IPO Lock-Up Violations; J.P. Morgan to Pay $150,000, Goldman Sachs $125,000 for Similar Violations (June 9, 2005).

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July 14, 2017

Submitted electronically to pubcom@finra.org

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

RE: Regulatory Notice 17-14: Capital Formation and Regulatory Notice 17-15: Corporate Financing

Dear Ms. Mitchell:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am pleased to submit the following comments in response to Regulatory Notice 17-14: Capital Formation, in which FINRA requests comment on its rules impacting capital formation, and Regulatory Notice 17-15: Corporation Financing, in which FINRA requests comment on FINRA Rule 5110 also known as the Corporation Financing Rule – Underwriting Terms and Arrangements (collectively, the "Proposals").

NASAA has worked closely with FINRA over many years on important regulatory matters as highlighted in prior comment letters.[2] This relationship stems from the fact that NASAA members regulate FINRA-member firms and the associated persons of those firms. We look forward to continued engagement with FINRA as it reviews existing rules and proposes new ones including those in the area of corporation finance.

1) Regulatory Notice 17-14

As stated in Regulatory Notice 17-14, FINRA is requesting comment on the effectiveness and efficiency of its rules as part of its new initiative—FINRA360. NASAA commends FINRA for undertaking a self-evaluation of its operations and programs, and for identifying opportunities "to more effectively further its mission." We believe this effort is both reasonable and appropriate,

[1] NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as a forum for these regulators to work with each other to protect investors at the grassroots level and promote fair and open capital markets.
[2] *See* Comment Letter from Mike Rothman, NASAA President and Minnesota Commissioner of Commerce, to Ms. Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA (June 19, 2017) (in response to the Special Notice – Engagement Initiative), *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/FINRA-Comment-Letter-Special-Notice-6-19-17.pdf

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Melanie Senter Lubin (Maryland)

especially considering capital formation needs of small and growing businesses. We urge any changes to be considered in light of FINRA's important and critical investor protection mission; capital formation rules must be balanced with providing strong investor protection. FINRA should evaluate the comments received by the firms and businesses it regulates that accounts for the needs and interests of both investors and issuers. This approach should serve to guard against regulatory capture by the very firms FINRA oversees. Below are NASAA comments regarding the FINRA Funding Portal Rules and FINRA Rule 2310.[3]

a) Funding Portal Rules

Title III of the Jumpstart Our Business Startups Act, or JOBS Act, enacted on April 5, 2012, and corresponding Securities and Exchange Commission ("SEC") rules established the regulatory framework for funding portals. NASAA commends FINRA for finalizing its Funding Portal Rules, which took effect on January 29, 2016,[4] and for taking swift action against one funding portal that violated several provisions of Regulation Crowdfunding and FINRA rules.[5] While funding portals may be new, startup businesses, we encourage FINRA to closely monitor the portals to ensure they are operating according to regulatory requirements. FINRA should require funding portals to conduct due diligence to determine if crowdfunding issuers are in compliance with SEC rules and remove any offerings that do not comply with such rules. In certain instances, enforcement action for practices that are not in the best interests of investors should be taken (for example, forward looking statements that project performance for which the startup issuer has no reasonable basis to provide or unsupported valuations).

NASAA also understands that some funding portals may be providing an array of other services to those companies and charging for those services. If those additional services are not necessary or provided at unreasonably high prices, FINRA should address this through rule drafting and/or enforcement. NASAA also encourages FINRA to provide greater guidance regarding the types and forms (i.e., warrants, options, etc.) of compensation a funding portal can receive from listed issuers. Finally, NASAA encourages FINRA and the SEC to work together with NASAA and its members to address potential issues that may present themselves in the registration of funding portals or other intermediaries that, depending on their registration status or business models, may be precluded from acting as an intermediary in an intrastate

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[3] FINRA is also seeking comment on its Capital Acquisition Broker ("CAB") rules. On January 15, 2016, NASAA submitted a comment letter to the SEC regarding the CAB rules, and we encourage FINRA to review that comment letter for any additional changes FINRA may consider as it reevaluates these rules. *See* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/FINRA-CAB-Comment-Letter.pdf.

[4] On November 19, 2015, NASAA submitted a comment letter to the SEC regarding proposed funding portal rules. The comment letter suggested requiring funding portals to use the Central Registration Depository to register and make ongoing disclosures, which would provide a central location for regulators to easily access information regarding funding portals. It also recommended requiring an associated person of a funding portal to obtain a license; requiring funding portal rules to more closely align with conduct rules for broker-dealers; requiring funding portals to maintain books and records; subjecting funding portals to Suspicious Activity Report filing requirements; and advocated against the ability of funding portals to place mandatory pre-dispute arbitration agreements in their customer agreements. NASAA continues to recommend these suggested changes to the extent they were not captured by the final rules. *See* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/NASAA-Comment-SR-FINRA-2015-040.pdf.

[5] *See* FINRA, Letter of Acceptance, Waiver, and Consent, No.201605156390, UFP, LLC (2016).

crowdfunded offering.[6]

b) FINRA Rule 2310 (Direct Participation Programs "DPPs")

NASAA commends FINRA for continuing to review Rule 2310 for direct participation programs.[7] These are complex offerings which involve significant ongoing transactions with affiliates of the sponsoring organization (i.e., investment advisory services, property management services, property acquisition and disposition services, etc.) and include an array of fees payable to the sponsor and its affiliates.

NASAA encourages FINRA to address complex deferred compensation arrangements that have become commonplace following FINRA Regulatory Notice 15-02. NASAA questions whether front-end compensation has been meaningfully lowered in the aftermath of 15-02 in light of increased higher back-end incentive fees. FINRA should reevaluate the net investment methodology under 15-02 and consider revising 15-02 to avoid certain broker compensation being disclosed as an expense. This approach could address the current complexity of the disclosures. Currently, an investor must measure multiple share classes and any quantity discounts applicable, and understand different complex deferred compensation arrangements. Offering circulars have disclosed deferred broker-dealer compensation as "ongoing shareholder servicing" or "distribution fees." This certainly implies the item as an expense as opposed to a commission. The compensation is paid regardless of the level of services provided by the broker. The disclosure may further imply that "ongoing shareholder services" are not available if the class of shares does not provide for this compensation, such as the typical Class A share. Similarly, it is unclear whether shareholder services would be available when the compensation ends. The fee should be referred to as a deferred commission and should be fully deducted from the value attributed to the account statement.

FINRA should also continue to watch valuations closely. Valuation firms have represented all programs by a sponsor, which then are included on customer account statements. Additional due diligence of the member firm should be required before using such valuation on the customer account statements. Finally, FINRA should evaluate the advertising review. A more appropriate balance of risks and rewards may require risks on the same line as the advertising content. Condensed boilerplate footnotes are not investor oriented.

2) <u>Regulatory Notice 17-15</u>

FINRA is seeking comment on proposed amendments to Rule 5110, which requires FINRA members who participate in an offering in which they are providing services to the issuer to file certain information with FINRA to review and approve prior to the offering taking place. The purpose of the rule is to ensure the underwriting terms are not unfair or unreasonable. As with Regulatory Notice 17-14, NASAA commends FINRA for seeking to modernize the rule and

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[6] For example, 15 U.S.C § 78c(a)(80) limits the definition of funding portals to those entities engaging in offerings pursuant to the federal interstate crowdfunding provisions, which may prevent these entities from effectively participating in intrastate crowdfunding.

[7] According to data compiled by *Direct Investments Spectrum*, non-listed REITs collectively raised $1.17 billion of investor capital in public offerings in the first quarter of this year. *See* www.dispectrum.com, May/June 2017.

simplify and clarify its provisions, but FINRA must remain mindful of the importance of balancing the dual interests of both issuers and investors.

Lock-Up Provisions

FINRA proposes to change the lock-up provisions for securities considered to be underwriting compensation to require lock-up for 180 days following the date of commencement of sales of securities (rather than from the date of effectiveness). FINRA proposes this change because the first sale may not occur until long after the date of effectiveness. NASAA supports the proposed change to FINRA Rule 5110 because it will provide increased protection for investors. However, we note that the NASAA Promotional Shares Statement of Policy[8] requires a lock-in period that is much longer than 180 days. Under the NASAA Policy, promotional shares that are not fully paid will be subject to a lock-in agreement for at least one to two years following the completion of the offering. This Policy is designed to ensure that investors and promoters assume similar risks in the offering. Accordingly, NASAA urges FINRA to consider requiring a longer lock-in period under Rule 5110 in order to more closely align the interests of the underwriters with those of the investors in the offering.

Disclosure of Underwriting Compensation

Regulation S-K requires that the fees and expenses identified by FINRA as underwriting compensation be disclosed in the prospectus. FINRA Rule 5110 requires a description of each type of underwriting compensation to be paid. However, this proposal would allow the total dollar amount of underwriting compensation to be presented as a maximum aggregate amount in the prospectus rather than itemized for each type of compensation. Any discount or commission received would still be disclosed on the cover page. NASAA supports the preservation of the existing required itemized underwriter compensation disclosure. While NASAA supports a simplified and streamlined cover of the prospectus, itemized compensation allows investors to understand how money is being disbursed to underwriters. It provides investors with a better understanding of incentives underlying an underwritten public offering, and provides investors additional liability protection for any misstatements in the disclosure.

Formula for Valuing Underwriter's Warrants

FINRA Rule 5110(e)(3) currently provides a formula for the valuation of options, warrants, and convertible securities that have an exercise or conversion price. The NASAA Underwriting Expenses Statement of Policy[9] uses the same formula for the valuation of underwriter's warrants for the purpose of calculating total underwriting expenses.

The FINRA proposal removes the formula, allowing underwriters to value 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 security (e.g. Black-Scholes model for options). FINRA states that this will ensure a "commercially reasonable valuation."

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[8] *Available at* http://www.nasaa.org/wp-content/uploads/2011/07/17-PROMOTIONAL_SHARES.pdf.
[9] *Available at* http://www.nasaa.org/wp-content/uploads/2011/07/10-UNDERWRITING_EXPENSES.pdf

NASAA believes the current valuation formula serves a useful purpose by providing an objective valuation method that provides consistency across different offerings. NASAA questions the rationale for eliminating this formula and seeks further clarification on the necessity of removing the formula. However, if FINRA does determine to eliminate the valuation formula, NASAA suggests FINRA consider reinstating the pre-2004 requirement that prohibited underwriters and related persons from receiving securities that constitute underwriting compensation in an aggregate amount greater than 10% of the number or dollar amount of the securities in the public offering. The pre-2004 rule would provide a limit on the amount of securities that may be received as underwriter's compensation. We also would suggest that FINRA consider retaining the existing formula as a continued optional method of valuation.

Exclusions from "Underwriting Compensation"

Rule 5110(d)(5) provides certain exclusions from "underwriting compensation." Pursuant to Rule 5110(d)(5)(A) and (B), certain securities obtained in prior private placements will be excluded from compensation if the conditions specified in the rule are satisfied. The FINRA proposal would revise Rule 5110(d)(5)(A) and (B) to remove the condition in Rule 5110(d)(5)(A)(ii) and (B)(iv) which makes the exclusion available only to underwriters (and their affiliates) who own less than 25% of the issuer's total equity. In its release, FINRA states that Rule 5121 addresses conflicts of interest more appropriately than the 25% provision in Rule 5110(d)(5)(A)(ii) and (B)(iv).

NASAA has concerns regarding the proposed removal of the condition that limits the availability of the above-described exclusions to underwriters who acquire less than 25% of the issuer's total equity. Without this condition, larger amounts of private placement securities may be excluded from the "underwriting compensation" subject to FINRA review. In addition, underwriters may be more likely to exceed 25% ownership in issuers than under the current rule. Accordingly, FINRA's proposed change may increase the potential for conflicts of interest to arise. While FINRA maintains that Rule 5121 can address these types of conflicts, we note that Rule 5121 requires only disclosure of conflicts of interest and that an independent underwriter prepare the registration statement with the usual standards of due diligence. NASAA questions whether these protections are adequate and whether the proposed change furthers investor protection.

Further, NASAA urges FINRA to reexamine whether it is appropriate for an issuer to grant any options or warrants to underwriters. Potential conflicts could impact the due diligence process. An underwriter may not search diligently for problems in a company if it is going to be an option holder. Also, once the firm that participated in the underwriting holds company options, it could potentially skew the recommendations that the brokerage then makes to its customers.

Miscellaneous

Finally, as part of FINRA's ongoing effort to revise its rules, NASAA asks FINRA to consider banning all sales contests and similar sales incentive non-cash compensation arrangements. Contests used to promote the sale of products create almost insurmountable conflicts of interest. A person who recommends securities based solely on such incentives is not acting in the best interest of the customer and is acting contrary to high standards of commercial honor and just and equitable principles of trade.

NASAA welcomes an opportunity to discuss these issues further. If you have any questions about these comments, please contact NASAA's General Counsel, A. Valerie Mirko, at vm@nasaa.org or (202) 737-0900.

Sincerely,

Mike Rothman

Mike Rothman
NASAA President
Minnesota Commissioner of Commerce

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June 27, 2017

Submitted via email to: pubcom@finra.org

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: FINRA Regulatory Notice 17-15
Request for Comment on Proposed Amendments
To FINRA Rule 5110 (The Corporate Financing Rule)

Dear Ms. Mitchell:

This letter is submitted in response to the request for comments published by the Financial Industry Regulatory Authority, Inc. ("FINRA") in FINRA Regulatory Notice 17-15 (April 2017) (the "Notice") with respect to proposed amendments to FINRA Rule 5110 (the "Corporate Financing Rule" or "Rule 5110") (the "Rule Proposal").

GENERAL COMMENT

In general, I support the Rule Proposal as it represents a significant clarification and modernization of a complex rule and appropriately narrows certain applications of the rule, thereby facilitating capital formation and decreasing the compliance burden of FINRA members without impacting investor protection. In particular, I support the narrowing of underwriting compensation to those items received by participating FINRA members for "underwriting, allocation, distribution, advisory and other investment banking services in connection with the public offering . . . ." The reorganization of the rule will facilitate the ability of FINRA members and their counsel to comply with the substantive requirements of Rule 5110.

Changes like the extension of the time for initial filing, the reduction of documents and information required to be filed, and the exclusion of the issuer from the definition of "participating member" are positive steps toward reducing some of the unnecessary burdens of compliance with the Corporate Financing Rule. Other proposed amendments would clarify important concepts, such as the proposed definition of "overallotment option" and the addition of supplementary material that provides an expanded list of the items that are included and excluded from underwriting compensation. In a number of cases, the proposed amendments are

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needed updates or corrections of current requirements, as is the proposal to revise to current Rule 5110(f)(2)(K) such that the prohibition on a FINRA member's participation in an offering if the issuer hires unregistered person to distribute securities will no longer be unnecessarily limited to situations involving a "non-underwritten issue of securities."

Following are my detailed comments on several aspects of the Rule Proposal.[1]

SPECIFIC COMMENTS

Clarify that Underwriting Compensation Will be Limited to Payments Made within the Review Period

The proposed definition of "underwriting compensation" in Section (i)(22) of the Rule Proposal would replace the current requirement that all items of value aquired by a participating FINRA member within the current 180-day review period be included in underwriting compensation by limiting underwriting compensation to "any payment, right, interest, or benefit . . . for underwriting, allocation, distribution, advisory, and other investment banking services in connection with a public offering." Although the Notice indicates that "FINRA would consider payments and benefits received during the applicable review period in evaluating underwriting compensation," the Rule Proposal does not include a provision that makes this clear. The only items of underwriting compensation proposed to limited to those acquired/received during the "review period," as proposed to be defined in Section (i)(20), are the equity and equity-linked securities identified in Supplementary Material .01(a)(7).

Clearly this change is unintended, as the Rule Proposal in its current form would, for the first time, include in underwriting compensation all payments (other than securities) were received for underwriting and other investment banking services in connection with the public offering regardless of when acquired or an agreement was entered into, thereby expanding the scope of Rule 5110 in an unprecedented manner.

This is to recommend that Section (a)(1) of the Rule Proposal, the definition of "underwriting compensation" in Section (i)(22) of the Rule Proposal, and/or the introduction to Supplementary Material .01(a) of the Rule Proposal be revised to clarify that only payments made and securities acquired during the review period will be included in underwriting compensation.[2]

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[1] This letter solely represents my views and focuses only on certain aspects of the Rule Proposal. I agree with many of the more complete comments submitted by SIFMA in its letter dated June 1, 2017.

[2] *See* current Rule 5110(d)(1).

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Reference a Standard for Determining When the Amount of Underwriting Compensation is Unfair and Unreasonable

Proposed Section (a)(1) sets out the general standard that "[n]o member shall participate in a public offering in which the terms and conditions relating thereto, including aggregate amount of underwriting compensation, are unfair and unreasonable pursuant to this Rule . . . ." (emphasis added). However, there is no reference in the text of the Rule Proposal to any standard for determining when the aggregate amount of proposed underwriting compensation is unfair and unreasonable. Such a codified standard appears necessary in order for FINRA staff to have a basis in the rule for its determination that the aggregate amount of underwriting compensation proposed for a public offering is unfair and unreasonable.

This is to recommend that FINRA include a provision that prohibits "participation in a public offering in which the aggregate amount of underwriting compensation exceeds the currently effective FINRA Corporate Financing underwriting compensation guideline."[3] Such a prohibition may be added to Section (f), which lists unreasonable terms and arrangements.

Publish the Rule 5110 Underwriting Compensation Guideline

The FINRA Corporate Financing underwriting compensation guideline (the "Guideline")[4] is a detailed chart of the maximum amount of underwriting compensation that differentiates between the amount of the offering proceeds, the type of securities offered, whether the offering is an initial or a follow-on offering, and whether the offering is underwritten on a "firm commitment" or a "best efforts" basis.[5] FINRA does not publish the Guideline for offerings that are subject to the compensation limitations of the Rule 5110.[6]

Many years ago, the National Association of Securities Dealers, Inc. ("NASD"), the predecessor to FINRA, Board of Governors concluded that it would be potentially harmful for the NASD to publish "approved" levels of underwriting compensation for corporate and other offerings subject to the compensation limitations of the version of Rule 5110 that existed at that time. The position of FINRA has been that the compensation guidelines are not levels which FINRA recommends but represent the maximum permissible levels to which FINRA will not object.[7] The NASD previously published statistics in NASD Notice to Members 92-53 (Oct.

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[3] *See* FINRA Rule 5110(c)(2)(D).

[4] It is my understanding that the compensation guideline has remained unchanged for several decades and there appears to be no plan to revise it.

[5] These details are currently set forth in FINRA Rule 5110(c)(2)(D).

[6] The only exception is that FINRA Rule 2310, governing offerings of direct participation programs and real estate investment trusts that will not be listed on a national securities exchange, includes the underwriting compensation limitation of 10 percent for any size offering.

[7] The FINRA underwriting compensation guideline chart has been reviewed by Securities and Exchange Commission staff in the context of its review of prior major revisions to the Corporate Financing Rule. *See* NASD Notice to Members 92-28 and attached Securities Exchange Act Release No. 30537 (April 15, 1992); 57 F.R. 77 (April 21, 1992).

1992) regarding the amount of underwriting compensation that was charged by members in the NASD's review of public offerings.

The absence of reliable information for FINRA members and their counsel as to the permissible level of underwriting compensation for offerings of various characteristics too often results in the submission of offerings to FINRA with excessive underwriting compensation, which leads to repetitive submissions by counsel in order to revise the compensation structure to come within an unknown limitation. While it is often thought that there is general knowledge about the Guideline for "firm commitment" underwritten initial public offerings ("IPO" or "IPOs") at the maximum offering proceeds included in the Guideline, my experience is that associated persons of FINRA members and their counsel often mistakenly believe that this amount is 10 percent. There is considerably less knowledge about the Guideline for follow-on and "best-efforts" underwritten offerings.

Given FINRA's current review of the Corporate Financing Rule, this is to request that FINRA reconsider its policy to maintain the confidentiality of the Guideline. The publication of the Guideline will assist issuers, underwriters and their counsel to structure the underwriting compensation for a public offering in compliance with the underwriting compensation limitation of Rule 5110 prior to filing with FINRA.

Modify the Standard for the Filing of Amended Documents

The Rule Proposal would modify the document filing requirements in proposed Rule 5110(a)(4)(A)(iii) to only require the filing of an amendment to a previously-filed document if there are "changes to the offering and the underwriting terms and arrangements . . . ." I anticipate that most changes to a registration statement and related documents could be viewed as either related to the offering or underwriting terms and arrangements. Moreover, any effort by FINRA to explain when an amendment is deemed to be a change to the offering will be likely be unsuccessful because counsel will generally prefer to err toward over-filing.

Therefore, to the extent that FINRA intended to limit the filing of amendments to changes relevant to the requirements of the FINRA underwriting rules, this is to recommend that FINRA modify the proposal to limit the requirement to file amended documents to situations where there are:

.....<u>changes that may affect the underwriting terms and arrangements</u>.

Revise the Standard Used for Determining When Straight Debt and Derivative Securities are Underwriting Compensation

The proposed definition of "underwriting compensation" in Section (i)(22) of the Rule Proposal would limit underwriting compensation to "any payment, right, interest, or benefit . . . for underwriting, allocation, distribution, advisory, and other investment banking services in connection with a public offering." However, in the case of non-convertible and non-exchangeable debt ("straight debt") and derivative instruments, the Proposed Rule would

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continue to loos to whether the securities were acquired in a transaction "related to the public offering."[8] The Rule Proposal does not include an explanation of the terms "related to the public offering" or "unrelated to the public offering," which are used in many provisions of the Rule Proposal.[9] Thus, the use of the concept of these terms is confusing.[10]

It appears more appropriate to solely treat such securities as underwriting compensation if not aquired at a "fair price" or to apply the standards in the definition of "underwriting compensation." As discussed below, I also recommend that straight debt securities be entirely excluded from underwriting compensation.

Exempt Straight Debt Securities From Underwriting Compensation

I do not believe that there is any investor protection purpose for treating straight debt securities as underwriting compensation due to the nature of the instrument that makes it unlikely to be used as a "payment . . . for investment banking services." In order to further modernize Rule 5110 consistent with investor protection, this is to request that FINRA consider at this time excluding straight debt securities from being treated as underwriting compensation.[11]

The Proposed Limited Exemption for Straight Debt: The Rule Proposal would modify the current exemption from underwriting compensation for straight debt (and derivative) instruments in proposed Supplementary Material .01(b)(19) by removing the "fair price" and "ordinary course of business" requirements and solely exclude such securities acquisitions if deemed acquired in a transaction that is "unrelated to the public offering."[12]

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[8] In addition, proposed Section 5110(a)(4)(B)(v)a. and b. use the term "related to the public offering" as the criteria for determining when information is required be filed regarding the acquisition of straight debt and derivative instruments.

[9] Other instances where the term "unrelated" to an offering is used to determine whether an item of value will be included in underwriting compensation are found in proposed Supplementary Material .01(b as follows: "(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation." This is to recommend that this provision be revised as follows: "(b) Participating members may receive payments from an issuer or another source during the review period that ~~may be unrelated to a particular offering. Such payments~~ generally would not be deemed to be underwriting compensation."

[10] An acquisition of straight debt securities by a participating FINRA member may be "related" to a public offering because (for example) the securities are issued to raise capial for operating or offering expenses and, yet, not be for the purpose of obtaining a payment for investment banking services. Moreover, there a debt-equity exchange structure in which participating FINRA members acquire the issuer's debt securities, which then may deemed to be underwriting compensation because the debt securities do not have a public market. And there are a number of offering structures involving derivatives, such as interest-rate swaps.

[11] Since I have difficulty identifying a scenario where a participating FINRA member would negotiate advantageous terms for the purchase of debt securities in order to obtain additional underwriting compensationt, the experience of the FINRA Corporate Financing Department would be instructive on the problematic situations that may require continued regulation of straight debt securities purchases.

[12] As previously stated, this standard is different than that set forth in the definition of "underwriting compensation." If an alternative standard is necessary, it appears more appropriate to exclude such instruments from underwriting compensation if acquired at a "fair price."

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Straight Debt is a Securitized Loan: I believe that straight debt should be treated under the Corporate Financing Rule in the same manner as a loan. Loans are often provided by a participating member or its affiliate to an issuer in the case of an IPO in order to assist the issuer to cover the considerable expenses of going public or to finance operations in the period before the IPO.

Since the repeal of the Glass-Steagall Act (adopted as part of the Banking Act of 1933 to separate commercial and investment banking) in 1999, a bank or other affiliate of one or more participating FINRA members will often have entered into a line of credit or loan with a company proposing to conduct an IPO or follow-on public offering of securities. Even though it could be argued that certain of such loans are "related to the public offering," the interest and fees received during the review period by the participating FINRA member and any of its affiliates for a loan to an issuer are not treated as underwriting compensation under the Corporate Financing Rule.[13]

Since a straight debt instrument is simply a securitized loan by multiple lenders to a borrower, I believe it is inconsistent to continue to include straight debt securities in underwriting compensation.[14]

Recommendation: This is to recommend that FINRA exempt the purchase of straight debt securities from underwriting compensation by amending Supplementary Material .01(b) to adopt a separate exemption for non-convertible or non-exchangeable debt securities without the caveate that such acquisition must be unrelated to the public offering.

To the extent that FINRA determines, nonetheless, to continue to treat straight debt as underwriting compensation, this is to recommend that FINRA adopt a more narrow exception from underwriting compensation for straight debt securities purchased at par (if the purchaser is the sole purchaser) or purchased at least at the same price as other purchasers at or about the same time for the same issue of debt (referred to hereafter as the "Straight Debt Valuation Method"). When such securities are purchased at a "fair price" using an objective method of valuation, there appears to be no investor protection benefit to including such securities in underwriting compensation.

Clarify the Valuation of Debt Securities Deemed To Be Underwriting Compensation

If, despite the recommendation set forth above, FINRA continues to treat straight debt securities as underwriting compensation, FINRA should revise how such debt securities are to be

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[13] The sole situation where a loan is related to the underwriting compensation requirements is when the lender receives fees in the form of equity or equity-linked securities.

[14] *See also* related comments below regarding the valuation of straight debt securities and the application of the Lock-Up Restriction to straight debt securities.

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valued under proposed Rule 5110, Supplementary Material .04.[15] Supplementary Material .04 states that straight debt (and derivative) securities acquired in a transaction related to the public offering that are purchased at a "fair price" will have no compensation value, but does not set forth an objective method for determining the "fair price." The provision further states that straight debt securities not acquired at a "fair price" in a transaction related to the public offering will be valued using a method that the FINRA member should describe in its submission to FINRA.

Because Supplementary Material .04 does not provide an objective method for determining the "fair price" or other value of straight debt instruments it is likely that counsel will often engage in unnecessarily drawn-out exchanges with FINRA staff on the appropriate valuation method to use.

This to recommend that proposed Supplementary Material .04 be revised to provide that straight debt securities determined to be underwriting compensation shall be valued using the Straight Debt Valuation Method discussed above.[16] This formula would provide an objective methodology for valuation that is appropriate to straight debt instruments that is consistent with investor protection.

Clarify the Valuation of Certain Equity Securities

The proposed valuation provisions in Rule 5110, Supplementary Material .02 would continue to provide two methods for valuation of equity securities deemed to be underwriting compensation depending on whether the securities are "non-convertible" or are "options, warrants and other convertible securities."

Clarify the Valuation of Unit Securities: However, the current Corporate Financing Rule and proposed Supplementary Material .02 do not identify how unit securities should be valued. Unit securities generally contain one or more shares of common stock and a warrant for some amount of common stock. Following the public offering of units, the unit security sold in the public offering will usually initially trade on a national securities exchange for a number of days and, thereafter, will split into its components so that the common stock and warrant will trade separately.

In the case of such public offerings of units, it is not unusual that securities acquired by a participating FINRA member in a private placement within the review period will also be structured as units with substantially the same terms as the publicly offered units (although at

[15] This provision also addresses the valuation of derivative securities.

[16] Although it is possible that the same series of debt securities may later be sold by the issuer in its public offering at a price that is above par or the price paid by the participating FINRA member, that premium would likely result from the independent impact of current interest rates on the public offering price. However, the publicly offered debt and the debt purchased by the participating FINRA member are more likely to be a different series of debt and, thus, not comparable for purposes of valuation.

times the private placement units and securities contained therein will have more restrictive terms than the public units and securities contained therein). Because the unit contains a warrant, it is not clear how the unit should be valued pursuant to current Rule 5110 and in accordance with proposed Supplementary Material .02. Unlike the stock exchanges that will list the unit for trading, it has appeared at times that it is FINRA policy to "look-through" the unit to value the individual components and ascribe an additional value to the warrant within the unit even though the purchaser may have paid the same price for the unit as the public offering price.

I believe that such a unit security should be valued as a non-convertible security under the valuation provisions because the unit is, in fact, a security that does not itself have an exercise or conversion price. Therefore, when a participating FINRA member acquires a non-convertible unit at the same price as the public offering price of the unit, such unit securities should have a zero valuation and should not be ascribed an additional value because they contain a warrant since the public is receiving the same warrant and, therefore, the same potential benefit that results from such warrant.

Include a Valuation Method for Securities With a Public Market: Supplementary Material .02 does not include an alternative method for valuing securities that have a public market at the time of purchase as is available in current Rule 5110(e)(2)(A). Thus, such securities would be required to be valued at the difference between the purchase and the public offering price ("POP") in the case of a follow-on offering of securities. The Notice does not address why this change was proposed.

Recommendation: This is to recommend that Supplementary Material .02 be revised as follows:

> The value of non-convertible securities (including units composed of common stock, warrants or other securities that are substantially the same as those being offered to the public) received as underwriting compensation will have a compensation value based on the difference between (i) either the public offering price per security or, if a *bona fide* independent market exists for the security, the market price per security on the date of acquisition; and (ii) the per security cost.[17]

Clarify Whether the Current Warrant Formula is an Acceptable Security Valuation Method

The Rule Proposal would eliminate a mathematical formula in current Rule 5110(e)(3) (the "warrant forumula), which has been the required method under the Corporate Financing Rule for valuing securities that have an exercise or conversion price. Instead, FINRA would permit FINRA members to rely on any securities valuation method that is commerciall available and is appropriate for the type of securities to be valued and require the filing of a description of the methodology with FINRA. I support this proposal but request a clarification.

[17] In addition, it is my understanding

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Although the warrant formula is being eliminated, there are situations where the warrant formula may continue to be a viable method for valuing securities. This is to recommend that FINRA advise whether, as a matter of policy, it will continue to accept the warrant forumula as a *bona fide* valuation method for securities that have an exercise or conversion price.

Reinstate the Current Scope of the Lock-Up Restriction

Introduction: I support the proposed revision to the lock-up requirement in proposed Rule 5110(d) (the "Lock-Up Restriction") that would once again only apply the Lock-Up Restriction to securities that are deemed to be underwriting compensation. However, I do not support other proposed changes to the Lock-Up Restriction that would expand its application to:

1. straight debt securities deemed to be underwriting compensation;
2. securities deemed to be underwriting compensation in offerings of debt securities; and
3. registered securities.

Perhaps this expansion was unintentional as there is no discussion of these material changes in the Notice. Nonetheless, in the event that the change was intentional, following are my comments.

Rationale for the Lock-Up Restriction: The primary purposes of the Lock-Up Restriction are to allow the public market for the issuer's equity securities to develop prior to a participating member selling their underwriting compensation securities into the public market and to address any incentive for fraud in the development of the aftermarket. Thus, the prohibition was apparently intended to address investor protection concerns that would tend to arise only in the context of an issuer's IPO or where the issuer's equity securities had a thin trading market.

Reinstate Limitation to Equity and Equity-Linked Securities: As previously discussed, any straight debt securities that are included in the calculation of underwriting compensation: (1) are likely a different issue or series than those sold to the public and will not have a public market; and (2) even if the securities are from the same issue, the public secondary market trading price of such debt instruments is primarily determined by fluctuating interest rates rather than the types of market forces that affect the equity markets. Therefore, consistent with FINRA's objective to modernize the Corporate Financing Rule, this is to recommend that straight debt securities deemed to be underwriting compensation should be excluded from the Lock-Up Restriction as there is no investor protection benefit that would be achieved.

Reinstate Limitation to Equity Offerings: There is no indication in the Notice that FINRA has identified an investor protection rationale for extending the Lock-Up Restriction to public offerings of debt when a participating FINRA member has received equity securities as underwriting compensation. In some cases, the equity securities will not have a public trading market. Where there is a public market in such equity securities, that market will be generally be unaffected by the issuer's debt offering. Thus, the Lock-Up Restriction should continue to only apply to securities deemed underwriting compensation in the case of public offerings of equity securities.

Reinstate Limitation to Unregistered Securities: There is no guidance in the Notice as to why FINRA is proposing to apply the Lock-Up Restriction to registered securities. Therefore, this is to request that FINRA reconsider whether there is any investor protection objective achieved by this expansion of the Lock-Up Restriction

Recommendation: Based on the foregoing, this is to recommend that FINRA revise the proposed Lock-Up Restriction in proposed Rule 5110(d) to state that the restriction, as it does currently, only applies in the case of a public equity offering to common or preferred stock, options, warrants, and other equity securities, including debt secuities convertible to or exchangeable for equity securities of the issuer, that are unregistered.

Modify the Lock-Up Restriction Period for Follow-On Offerings

While the 180-day lock-up in the case of an IPO continues to be consistent with the industry practice that limits the resale of equity securities by the officers, directors and insiders of the issuer following the IPO, this is to recommend that the Lock-Up Restriction be shortened in the case of a follow-on offering of equity securities.

In consideration of the market dynamics that generally result from after-market stabilizing and covering transactions by the managing underwriter, FINRA may wish to consider that the Lock-Up Restriction for follow-on offerings should be as long as the contracted term of the overallotment option (which would thereby serve as an objective standard), which generally is 30 days but may be as long as 45 days, or 30 days following the commencement of sales in the event there is no overallotment option (as in the case of a "best-efforts" underwritten offering).

Expand the Exemption for Securities Acquired Through Section 401 Qualified Plans

Proposed FINRA Rule 5110, Supplementary Material .01(b)(12) would incorporate the current exemption from underwriting compensation for securities acquired by an underwriter and related person through any stock bonus, pension, or profit-sharing plan ("employer plan") that qualifies under Section 401 of the Internal Revenue Code ("IRC") (the "Exemption"). This Exemption is proposed to be adopted with the addition of the words "or a similar plan."

Increasingly, there have been offerings where securities were acquired by associated and affiliated persons of a participating member through a *bona fide* employer plan that was not, however, formed in compliance with the tax-advantaged provisions of Section 401. These securities acquisitions (1) did not raise investor protection concerns; (2) occurred in the normal course of the persons' employment or in the ordinary course of business; and (3) were not in anticipation of participating in any underwritten offering or with any intent to persuade a FINRA member to underwrite an offering.[18]

[18] Certain of the situations where this issue has occurred will be addressed by FINRA's proposal to exclude the "issuer" from the definition of "participating member." However, other situations would benefit from a case-by-case determination by FINRA staff. *See* comment regarding these definitions below.

I support an amendment that would permit FINRA staff to consider on a case-by-case basis excluding securities from underwriting compensation that are granted under other types of employer plans that are not formed pursuant to IRC Section 401. However, I am unable to support this amendment as proposed because it could be interpreted now or far in the future to require that the "similar" employee plan be another type of IRS tax-advantaged employee plan or that the plan must have terms that are similar to those of an IRC Section 401 plan, although this narrow scope may not have been intended by FINRA.

With the caveat that I am not a tax law expert, my research indicates that there are no other relevant IRS tax-advantaged employee plans that an issuer may establish that would result in the issuance of securities that would be treated as underwriting compensation under Rule 5110.[19] A Section 401 plan must satisfy a number of IRC requirements, including that the plan "not discriminate in favor of highly compensated employees," *i.e.,* the plan must be available to all employees. Section 401 plans are subject to ERISA reporting, disclosure and fiduciary responsibility requirements. Although Section 401 allows for the creation of a stock bonus, pension, or profit-sharing plan, a typical Section 401 plan is structured under Section 401(k) as a pension plan that allows the issuer and employee to make tax-deductible contributions to the plan for the purpose of purchasing securities. Thus, Section 401 plans cannot be formed as a stock compensation or incentive plan, cannot benefit company directors, and are usually formed only for a stock pension plan.

A private company is less likely than a public company to have an employee plan that complies with IRC Section 401. Instead, a private company is likely to establish a plan that provides stock compensation, bonuses and incentives to the company's more highly compensated officers and directors in order to attract qualified management and directors to the company.[20] Therefore, the securities to be awarded under such non-tax qualified stock compensation, bonus, and incentive plans do not receive favorable tax treatment under the IRC.

This is to recommend that FINRA revise the proposed Exemption as follows in order to extend the exemption to other types of *bona fide* employee and director plans:

> compensation received through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code <u>or, as determined on a case-by-case basis, compensation received through any other type of written plan that was initially established in the ordinary course of business</u>.

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[19] For example, IRC Section 422 allows a company to grant incentive stock options to employees (not stock incentives that are not options), so that the employee is exempted from paying ordinary income tax on the difference between the option exercise price and the fair market value of the shares. In addition, IRC Section 423 permits companies to use employee stock purchase plans to allow their employees to make discounted purchases of employer securities by exercising options at regular intervals.

[20] Many public companies will also establish such non-tax-qualified plans in addition to an IRC Section 401(k) pension plan.

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The generic reference to "any other type of plan" in the above proposed change to the Exemption is intended to cover any cash or stock compensation, bonus, pension and incentive or profit-sharing plan.

Revise the Definitions of "Participating Member" and "Issuer"

While I agree with the proposal to exclude the "issuer" category from the definition of "participating member," the addition of the words "other than the issuer" at the end of the definition does not make it clear that the issuer, as defined in Rule 5110, is exempted from all of the categories of a "participating member" rather than just from the category of "immediate family." Therefore, this is to request that FINRA replace the words "other than the issuer" with:

> .....<u>; provided, however, that the term "participating member" shall not include the "issuer."</u>

In order to completely address the practical problems that occur when a person or entity is within both the definitions of "issuer" and "participating member," this is to also recommend that FINRA amend the definition of "issuer" to similarly exclude "any participating member" from the definition consistent with the form of the recommendation in the prior paragraph.

Request for Comment on Need for a Stock Numerical Limitation

In the Notice, FINRA requests comment on whether a form of Stock Numerical Limitation should be reinstated. I believe it is likely that a Stock Numerical Limitation would create more unnecessary problems than it would resolve unless limited to the types of securities that present investor protection concerns.

Background: Since the Stock Numerical Limitation was eliminated as part of the 2004 amendments to the Corporate Financing Rule, it may be helpful to review the purpose and operation of the Stock Numerical Limitation as I understand these matters. In general, the Stock Numerical Limitation was originally intended to ensure that the underwriters as a group could not acquire a disproportionate amount of the issuer's securities, regardless of whether the other terms and arrangements were in compliance with the Corporate Financing Rule. Therefore, "underwriters and related persons," in the aggregate, were limited to acquiring or receiving as underwriting compensation securities in excess of 10 percent of the securities sold in the public offering (without including the overallotment option).

The Stock Numerical Limitation operated effectively in an era when commercial and investment banking institutions were not affiliated and securities acquired as underwriting compensation securities were almost always in the form of "underwriter's warrants" (warrants that were granted to the underwriters as part of the formal underwriting compensation arrangement with the issuer) and pre-filing private placement stock purchases. While stock purchases were effectively limited by the inclusion of the value of the stock in underwriting compensation as well as the Stock Numerical Limitation, acquisitions of warrants were and remain more problematic.

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At that time and currently, when underwriter's warrants have an exercise price that is 165 percent of the POP, the application of the current warrant valuation formula in Rule 5110(e)(3) results in a zero valuation regardless of the number of securities underlying the warrants. Currently, Rule 5110(e)(3)(H) places a limit on the amount of securities by applying a minimum valuation to securities that have an exercise or conversion price (the "Minimum Value provision").[21] Therefore, when warrants are valued at zero, absent compliance with the prior Stock Numerical Limitation or the current Minimum Value provision, the underwriter would be able to obtain warrants for any amount of the issuer's securities. The only remaining "restriction" on the underwriter benefiting financially from such warrants and becoming a major shareholder of the issuer is if the market price of the issuer's securities failed to rise above 165% of the POP during the five-year period that such warrants may be exercised pursuant to Rule 5110(f)(2)(G).[22]

The Current Dynamics of Acquisitions of Underwriting Compensation Securities: With the elimination of the Glass-Steagall Act, as referenced above, FINRA amended Rule 5110 in 2004 ". . . to ensure that the Rule would accommodate the modern, legitimate corporate financing activities of members, while protecting issuers and investors from unreasonable or coercive practices."[23] The Rule Proposal indicates that FINRA remains committed to regulating underwriting compensation in a manner that does not prevent FINRA members and their affiliates from continuing to provide a variety of services to their corporate financing clients, including loans to and venture-type investments in the issuer. Consistent with the foregoing FINRA should not now impose a Stock Numerical Limitation in a manner that would artificially restrict such permissible venture, lending and other services that benefit corporate financing clients.

Moreover, any numerical restriction on private placement purchases by a FINRA member and its affiliates of the securities of the issuer would be contrary to the interests of issuers that often look to the FINRA members that will participate in its public offering to also purchase a significant portion of any pre-IPO private placement. Similarly, the customers of such FINRA members that purchase pre-IPO private placement securities generally expect that the FINRA member will share the risk of the investment by being a co-investor. With respect to securities acquired in venture and lending activities where the participating FINRA member must make a significant financial investment, the underwriting compensation guideline has and will effectively continue to limit the amount of securities acquired as underwriting compensation.

Recommendation to Limit any Stock Numerical Limitation to Underwriter's Warrants: However, in the case of underwriter's warrants, the underwriting compensation guideline will not necessarily be effective in restricting the amount of securities when it is possible that to

[21] This provision indirectly limits the amount of securities that could potentially be acquired by an underwriter through the underwriting compensation limitation. The Rule Proposal does not include a similar provision that would ascribe a minimum value to warrants and similar securities.

[22] This provision is proposed to be retained in proposed Rule 5110(f)(7).

[23] NASD Notice to Members 04-13 (February 2004), at 114.

structure the warrants with a high exercise price so that the warrant valuation is zero or close to zero.

Therefore, to the extent that FINRA does not identify another method to address the amount of underwriter's warrants, this is to recommend that FINRA adopt a Stock Numerical Limitation applicable in the aggregate to all participating FINRA members of 15 percent[24] only with respect to a narrow category of stand-alone grants of underwriter's warrants by the issuer. Thus, such a limitation should not apply in the case of warrants purchased for a "fair price," or that are granted in association the purchase of common stock or any other security, a loan, or a credit facility, and other situations where the FINRA member has undertaken significant financial risk.

* * * *

I appreciate the opportunity afforded by FINRA to submit these comments on significant proposed amendments to the Corporate Financing Rule. If you require further information regarding these comments, please contact the undersigned.

Very truly yours,

Suzanne Rothwell

Suzanne Rothwell
Managing Member

[24] The 15 percent number is recommended in light of the restriction on the exercise period of such warrants and that the limitation is applied in the aggregate to all participating members.

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July 14, 2017

VIA EMAIL

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(pubcom@finra.org)

Re: FINRA Regulatory Notices 17-14 and 17-15

Dear Ms. Mitchell:

This letter is submitted by Jones Lang LaSalle Income Property Trust, Inc. ("JLL Income Property Trust") and LaSalle Investment Management Distributors, LLC ("LaSalle Distributors"), a member of the Financial Industry Regulatory Authority, Inc. ("FINRA"), in response to FINRA's requests for comment issued on April 12, 2017 pursuant to FINRA Regulatory Notices 17-14 and 17-15. JLL Income Property Trust is an institutionally managed, daily net asset value ("NAV") real estate investment trust ("REIT") that has operated as a perpetual-life, publicly offered non-listed REIT ("PLR") since 2012. As of December 31, 2016, JLL Income Property Trust owned interests in a total of 70 properties, 69 of which are located in 18 states and one of which is located in Canada, with an investment amount of approximately $2.2 billion and comprising approximately 13.5 million net rentable square feet. LaSalle Distributors has been a FINRA member since 2012 and serves as the dealer manager for JLL Income Property Trust's continuous public offering by coordinating the distribution effort, managing relationships with participating broker-dealers and providing assistance with compliance matters. JLL Income Property Trust's sponsor, Jones Lang LaSalle Incorporated, is a leading professional services firm that specializes in real estate and investment management with a portfolio of approximately three billion square feet worldwide, and LaSalle Investment Management, Inc., JLL Income Property Trust's advisor, is one of the world's largest managers of institutional capital invested in real estate and real estate-related assets. Together we are pleased to submit this letter in response to FINRA's request for comment relating to FINRA rules affecting capital formation. We appreciate FINRA's efforts to engage in continued review of its rules in response to changes in the capital markets and its willingness to consider the effectiveness and efficiency of its existing rules in practice.

Under FINRA Regulatory Notice 17-15, FINRA's proposed amendments to FINRA Rule 5110 (the "Corporate Financing Rule") include adding follow-on offerings of closed-end "tender offer" funds ("Tender Offer Funds")[1] that routinely make self-tender offers and need to be in continuous distribution to offset net redemptions to the list of offerings exempt from the filing requirements of the Corporate Financing Rule, although they would remain subject to the Corporate Financing Rule's prohibitions on unreasonable underwriting terms and arrangements. FINRA Regulatory Notice 17-15 also proposes

[1] Tender Offer Funds are registered closed-end management investment companies that make periodic self-tenders in compliance with Rule 13e-4 and Schedule 13E-4 under the Securities Exchange Act of 1934, as amended.

making compensation for distribution of continuously offered Tender Offer Funds subject to the limitations of FINRA Rule 2341 (Investment Company Securities). We believe that FINRA should extend similar treatment to that which it proposes to give to continuously offered Tender Offer Funds to PLRs by exempting PLRs from the filing requirements of the Corporate Financing Rule and by making PLRs subject to the sales charge limitations of FINRA Rule 2341 rather than the limitations of FINRA Rule 5110 and FINRA Rule 2310 (Direct Participation Programs) or, alternately, amend FINRA Rule 2310 to provide sales charge limits similar to FINRA Rule 2341 for continuously offered PLRs.

With respect to sales charge limitations, we believe that FINRA should take the same approach with continuously offered PLRs that it takes with open-end investment management companies under the Investment Company Act of 1940, as amended (the "1940 Act") ("Open-End Funds"),[2] certain closed-end management companies ("Closed-End Funds")[3] that make periodic repurchases of their securities under Rule 23c-3(b)[4] of the 1940 Act ("Interval Funds") and offer their shares on a continuous basis pursuant to Rule 415(a)(1)(xi) under the Securities Act of 1933, as amended (the "Securities Act"),[5] and proposes to take with continuously offered Tender Offer Funds because PLR's are structured in a manner more like Open-End Funds and continuously offered Interval Funds and Tender Offer Funds. Given the similarities between the manner in which PLRs are offered and sold to investors and the means by which PLR investors obtain liquidity for their shares to the manner in which Open-End Funds, continuously offered Interval Funds, and continuously offered Tender Offer Funds are offered and sold and by which their investors obtain liquidity, we believe that the limit on underwriting compensation under FINRA Rule 2310 of 10% of the gross proceeds of an offering (excluding securities purchased through the reinvestment of dividends), taking into account "the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of 'trail commissions,' payable to underwriters, broker-dealers, or affiliates thereof" is inappropriate for PLRs.[6] Rather, we believe that, similar to Open-End Funds and continuously offered Interval Funds, and as proposed for continuously offered Tender Offer Funds, FINRA Rule 2341's requirements that anticipate ongoing asset-based sales charges for continuous offerings, as opposed to a hard cap on the gross proceeds of an offering, would be more appropriate for PLRs.

We believe that relief for PLRs from the filing requirements of the Corporate Financing Rule relief and the application of the sales charge limitations of FINRA Rule 2341 would greatly improve investor access to PLRs, allowing PLRs to raise capital more effectively and efficiently, which in turn would allow investors greater potential for diversification among asset classes and types and across investment vehicles without compromising investor protections. Furthermore, if this relief is granted, we believe that small and

[2] Section 5(a)(1) of the 1940 Act defines "open-end company" as "a management company which is offering for sale or has outstanding any redeemable security for which it is the issuer." 15 U.S.C. 80a-5(a)(1).

[3] Section 5(a)(2) of the 1940 Act defines "closed-end company" as "any management company other than an open-end company." 15 U.S.C. 80a-5(a)(2). While Closed-End Funds are subject to the core provisions of the 1940 Act that also apply to Open-End Funds, including prohibitions on affiliated transactions, obligations requiring stockholder approval of advisory contracts, anti-pyramiding restrictions, and board composition requirements, they are not subject to other 1940 Act restrictions applicable to Open-End Funds, including limitations on leverage and obligations pertaining to the liquidity of investments.

[4] 17 CFR 270.23c-3(b).

[5] We note that not all "interval funds" are continuously offered. *See* Securities Exchange Act Release No. 42965 (June 20, 2000); 65 F.R. 39640 (June 27, 2000).

[6] FINRA Rule 2310(b)(4)(B)(ii).

large real estate investment management firms would create substantial new jobs and spur economic growth, consistent with FINRA's stated objectives in FINRA Regulatory Notice 17-14.

PLRs vs. Traditional Non-Listed REITs

A PLR is a type of non-listed REIT that registers with the Securities and Exchange Commission (the "SEC" or the "Commission") pursuant to a registration statement on Form S-11 under the Securities Act. Public offerings of non-listed REITs are generally subject to the sales charge limitations of Rule 2310. Currently, there are two types of non-listed REITs offering shares to the public in the market, traditional non-listed REITs, which have offered shares for over 20 years, and PLRs, which have only begun to raise significant capital in the last few years. Traditional non-listed REITs have a finite date for liquidation (generally five to ten years after the initial public offering begins) and offer only very limited liquidity prior to the consummation of a liquidity event, which may be a listing of the REIT's shares on a national securities exchange, a sale or merger in which stockholders receive cash and/or listed securities in exchange for their shares of the REIT or a liquidation of the REIT's assets followed by a distribution of the cash proceeds to stockholders. Prior to a traditional non-listed REIT's liquidity event, liquidity is available through the traditional non-listed REIT's share repurchase plan only on a very limited basis at steep discounts and is generally intended to be available only for unexpected circumstances such as death or disability. Traditional non-listed REIT share repurchase plans also typically only redeem up to 5% of the outstanding shares on an annual basis.

In contrast, PLRs intend to conduct a continuous offering of an unlimited amount of shares of common stock, generally of multiple share classes, over an unlimited time period, by filing a new registration statement prior to the end of the three-year period described in Rule 415 under the Securities Act. PLRs have no finite date for liquidation, and the only anticipated source of liquidity for stockholders is the PLR's share repurchase plan. While traditional non-listed REITs generally offer shares to the public at an arbitrary fixed price, PLR shares are offered for sale on a daily or monthly basis at the NAV per share for shares of such share class, plus any applicable up-front fees, and the PLR repurchases such shares on a daily or monthly basis at the NAV per share for such share class.

The PLR's perpetual-life structure was designed to address the well-known shortcomings associated with traditional non-listed REITs by simplifying the capital raising process to benefit investors through lower fees payable to broker-dealers and the REIT's external advisor, more liquidity and flexibility with respect to investment timing decisions and better alignment of the advisor's interests with those of investors. Greater details on customary fees and repurchase programs of PLRs are provided below, but the principal benefits include:

- *Greater Portion of Offering Proceeds Immediately Available for Investment and lower fees over the traditional non-listed REIT.* A greater percentage of the PLR's offering proceeds will be immediately available for investment because the PLR will pay lower up-front selling fees. Approximately 87% of a traditional non-listed REIT's offering proceeds are available for immediate investment after the payment of selling commissions, dealer manager fees and acquisition fees, whereas PLRs frequently have 97% or higher offering proceeds available for immediate investment. This enables PLRs to generate higher returns for investors over time than traditional non-listed REITs. Over a seven-year investment holding period (the approximate average expected life of traditional non-listed REITs), an investor is also likely to pay less selling compensation compared with the total up-front selling compensation typically paid with respect to traditional non-listed REITs due to the lower up-front fees.

- *Alignment of Financial Advisors' Incentives with Investors' Goals.* By structuring a portion of the selling compensation in the form of NAV-based trail fees, PLRs create an ongoing incentive for financial advisors to monitor and service their clients' investments in the PLR, as well as for financial advisors to continue to market the PLR to create a larger investment base. Traditional non-listed REITs, which offer very limited liquidity and require up-front payment of all selling compensation, provide little incentive to service a stockholder's investment on an ongoing basis. There is little need for financial advisors to monitor stockholders' investments in traditional non-listed REITs in order to determine the optimal time for liquidation, review investment performance or to ensure the investment is consistent with an investor's financial goals because, as described above, these products are offered at a static, arbitrary amount for extended periods of time without valuing the underlying assets and these stockholders do not have the opportunity to liquidate their investment at the time of their choosing absent the very limited redemption plans that are intended for emergency use only.

  Traditional non-listed REIT shares are offered at a single price and even the current customer account statement requirements under FINRA Rule 2340 only require an annual valuation of the REIT shares commencing 150 days after the two year anniversary of the escrow break for the REIT's initial public offering. As a result, financial advisors do not need to monitor investments in traditional non-listed REITs on a regular basis because the share values change so infrequently. However, for PLRs the share prices change on a monthly or even daily basis, as in the case of JLL Income Property Trust, to reflect changes in the underlying value of the REIT's changing portfolio of investments. These frequent pricing adjustments require that financial advisors constantly monitor investments in PLRs on behalf of stockholders. In addition, the fact that PLRs exist for an indefinite amount of time means that these financial advisor responsibilities remain in place permanently (so long as the investor's investment remains outstanding), and financial advisors should continue to be compensated appropriately while they are providing these and other stockholder servicer services, rather than be limited by arbitrary offering-based caps. The PLR's perpetual life structure also allows financial advisors to keep investors in an investment that fits their portfolio and investment goals without having to recycle, as they would in the case of a traditional non-listed REIT upon its liquidity event. Moreover, to the extent liquidity is available to a stockholder of a traditional non-listed REIT through its limited share repurchase program, the up-front payment of all selling compensation creates a perverse incentive for financial advisors to encourage their clients to seek redemption of their shares sooner than may otherwise be in the client's best interest in order to reinvest in other products for the sole purpose of generating additional fees. Finally, the ongoing fees paid by PLRs provide incentives for financial advisors to continue to expand a PLR's stockholder base, which helps to lower the overall overhead costs incurred by the PLR due to the expanding stockholder base over which a PLR can spread these expenses. This means that more funds are available for investment and distribution to stockholders of the PLR.

- *More opportunity to redeem shares without penalty and participate in share appreciation.* As described below, PLRs have expanded share repurchase programs, which allow investors to hold their investments for widely varying periods of time.

> PLRs provide daily or monthly valuations of their share values based on the appraised value of the underlying assets and redeem their shares based on these valuations. PLRs also charge substantially lower up-front fees. These features allow investors to immediately participate in any appreciation in value in their shares over the time period for which they hold their shares, rather than having to wait seven years or longer for a liquidity event to participate in any appreciation in value of the underlying assets, and enable stockholders with relatively shorter holding periods to redeem their shares without incurring a 10% loss (the typical penalty charged by traditional non-listed REIT repurchase plans), which loss unfairly penalizes redeeming stockholders with relatively shorter holding periods. This means that an investor in a PLR can redeem out without losing a large portion of his or her investment immediately due to up-front costs, while at the same time experiencing an appreciation in the underlying value of his or her shares.

Unlike traditional non-listed REITs, a PLR's share repurchase plan is intended to be the primary source of liquidity for stockholders. Subject to certain limitations, PLR share repurchase plans are intended to allow stockholders the opportunity to request that the PLR repurchase their shares in an amount up to approximately 20% of the PLR's NAV per year. Some PLRs, including JLL Income Property Trust, require a one-year holding period before shares are eligible for repurchase. Others do not have any holding period requirement, but rather impose a short-term trading discount of 2% for shares redeemed within the initial year after purchase. Even with the short-term trading discount however, a stockholder would still be able to participate in any appreciation in the NAV and would have lower up-front costs than the traditional non-listed REIT's costs of 10% up-front sales charges. This frequently means that a PLR will redeem up to 5% of its NAV in any given quarter and potentially up to 10% in a given quarter because unused amounts in a previous quarter can be rolled over into subsequent quarters, whereas a traditional non-listed REIT is generally limited to redeeming 5% of its shares in a calendar year. PLR repurchase requests are generally fulfilled on a first-come, first-served basis, but may be filled on a per stockholder allocation basis, if the cap is reached in any given quarter.

While a PLR's board of directors' primary objective regarding share repurchase plans is generally to maintain the uninterrupted repurchase of shares in order to provide stockholders with liquidity in respect of their investment in the PLR, the board of directors has the ability to suspend the repurchase of shares in appropriate circumstances, as well as to make appropriate modifications to the share repurchase plan to ensure its effective operation. The fiduciary duties of the board of directors require that any decision to modify or suspend the share repurchase plan must be made in good faith, with a reasonable belief that the action is in the best interest of the PLR and its stockholders.

Sales charges for PLRs typically consist of a combination of up-front and trailing commissions and fees. The up-front sales commission usually ranges from 0% to 3.5%, the upfront dealer manager fee usually ranges from 0% to 0.5%, and the trailing distribution, dealer manager or stockholder servicing fees ("trailing fees") are paid annually on a trailing basis and range from 0.05% to 1.05% of average daily net assets, each of which varies by share class. We note that the cumulative fees, including stockholder servicing fees, remain subject to the overall 10% cap on underwriting compensation and the 15% cap on organization and offering costs under FINRA Rule 2310, and PLRs are currently required to monitor such fees and stay within the caps. In practice this means that PLRs must monitor FINRA Rule 2310's caps for purposes of each three-year offering that they conduct under Rule 415 under the Securities Act and have to terminate all fees with respect to shares sold in an offering once they reach the caps for the offering. We believe that regulating PLRs under FINRA Rule 2341 instead would greatly simplify the sales and monitoring process, again lowering costs and increasing capital flows, which would benefit all investors.

Traditional non-listed REITs, by contrast, have typically only had a one-time up-front sales commission of approximately 7% and a one-time up-front dealer manager fee of approximately 3%. Although traditional non-listed REITs typically do not have trailing fees, we note that some have recently begun incorporating annual trailing fees of up to 1.125%, in connection with marginally lower up-front fees. These fees are also subject to the overall 10% cap of the gross offering proceeds of FINRA Rule 2310 and the traditional non-listed REIT would need to terminate such fees if it reached the 10% cap.

The dealer manager fees, whether upfront or trailing, for PLRs are generally paid to the dealer manager in consideration of the distribution, marketing and ongoing services that the dealer manager provides to the PLR in connection with the continuous offerings. All or a substantial portion of the dealer manager fee and/or distribution fee is reallowed to participating broker-dealers as compensation to the participating broker-dealers based on, among other factors, certain asset thresholds of shares under management and to compensate the participating broker-dealers for their role in distributing and marketing the PLR's shares. All or a substantial portion of the stockholder servicing fees are generally reallowed to participating broker-dealers for providing ongoing services to those stockholders who invest through that particular broker-dealer, thus saving the dealer manager that expense. Stockholder services provided by participating broker-dealers in consideration for these trailing fees include: assistance with recordkeeping; answering investor inquiries regarding the PLR, including regarding distribution payments and reinvestments; helping investors understand their investments upon their request; and assistance with share repurchase requests. PLRs utilize various combinations of trailing fees to compensate for a variety of distribution and stockholder servicing expenses, whereas traditional non-listed REITs have only begun to utilize trail fees to compensate for providing stockholder services.

Regulating PLRs under FINRA Rule 2341 would also be fairer to stockholders of varying share classes not sold through wrap or other similar accounts. Investors through wrap or other similar accounts pay their financial advisors a fee based on the client's assets under management and are eligible to purchase PLR share classes that do not bear any upfront sales charges or trailing fees. The financial advisors to wrap and similar account investors provide similar monitoring and stockholder services that investors in other share classes receive from their financial advisors who are paid the trailing fees in consideration for such services. Allowing PLRs to be regulated under FINRA Rule 2341 would enable all financial advisors whose clients hold PLR shares to receive appropriate compensation for providing similar services to investors for the life of their investment, regardless of share class, as opposed to an arbitrary cut-off date for compensation paid on brokerage account share classes during the life of the investment under current rules.

Similarities Between PLRs, Open-End Funds and Continuously Offered Interval Funds

The manner in which shares of PLRs are structured, and in which stockholders realize liquidity for their shares, as discussed above, is more like Open-End Funds and continuously offered Interval Funds than it is like traditional non-listed REITs. Like Open-End Funds and continuously offered Interval Funds, which price and offer their shares daily at NAV, PLRs generally conduct a series of continuous offerings of an unlimited amount of shares of common stock, over an unlimited time period, by filing a new registration statement prior to the end of the three-year period described in Rule 415 of the Securities Act.

Like Open-End Funds and continuously offered Interval Funds, PLRs offer to repurchase their shares at NAV from stockholders. More like Open-End Funds, PLRs offer to repurchase their shares on a daily or monthly basis, while continuously offered Interval Funds do so periodically. Unlike Open-End Funds but similar to continuously offered Interval Funds, the amount of a PLR's assets that can be repurchased during a particular period is limited to a certain percentage of the PLR's total assets (*i.e.*, in an amount up to approximately 20% of the PLR's NAV per year).

Additionally, PLRs' trailing fees are much more like the fees charged by Open-End Funds and continuously offered Interval Funds than they are like the fees of traditional non-listed REITs. While traditional non-listed REITs typically have a high up-front sales commission of 7%, as well as an up-front dealer manager fee of 3%, PLRs generally have a lower up-front sales commission and upfront dealer manager fee, and a trailing distribution and/or stockholder servicing fee. Open-End Funds and continuously offered Interval Funds tend to have an up-front sales commission of up to 5.75% and an ongoing distribution and/or shareholder servicing fee, or in the case of an Open-End Fund, a Rule 12b-1 fee,[7] of up to 1.00%, depending upon share class. We believe that the trailing fees that PLRs pay are comparable to distribution and/or shareholder servicing fees paid by Open-End Funds pursuant to Rule 12b-1 under the 1940 Act, as well as the equivalent fees paid by continuously offered Interval Funds pursuant to exemptive relief under the 1940 Act.[8] Under FINRA Rule 2341, however, the shareholder servicing component of these trailing fees paid by Open-End Funds and continuously offered Interval Funds, whether paid pursuant to or outside of a Rule 12b-1 plan, are not subject to the asset-based sales charge limits of the Rule.[9] Similar fees paid by continuously offered PLRs, on the other hand, are currently subject to the 10% cap on underwriting compensation under FINRA Rule 2310, thereby limiting how long such fees for the provision of ongoing stockholder services may be paid to those continuing to provide such services.

Distinctions Between PLRs, Open-End Funds and Continuously Offered Interval Funds

While continuously offered PLRs have numerous similarities to Open-End Funds and continuously offered Interval Funds in the manner in which their shares are offered and sold, we acknowledge that there are some differences between the vehicles, namely that PLRs, unlike Open-End Funds and continuously offered Interval Funds, are not registered under the 1940 Act. Additionally, both Open-End Funds and continuously offered Interval Funds are required by the 1940 Act to redeem their shares at certain periods – daily in the case of Open-End Funds. In the case of an Interval Fund, Rule 23c-3(b)(2)(i) of the 1940 Act requires that the Interval Fund's board of directors establish as a fundamental policy, changeable only by a majority vote of the outstanding voting securities of the Interval Fund, that they will make periodic repurchases of the Interval Fund's shares.

Distinctions Between PLRs, Open-End Funds and Continuously Offered Interval Funds Should not be Determinative with Respect to the Requested Relief

While Not Subject to the 1940 Act, PLRs are Subject to Extensive Regulation

While PLRs are not regulated under the 1940 Act, both PLRs and traditional non-listed REITs are highly regulated under the Internal Revenue Code of 1986, as amended (the "Code") and the Statement of Policy Regarding Real Estate Investment Trusts, as revised and adopted by the NASAA membership on May 7, 2007 (the "NASAA REIT Guidelines") through the blue sky jurisdictions. Unlike typical corporations, the Code requires REITs to annually distribute 90% of their taxable income as distributions to their stockholders. The Code also has strict parameters regarding the type of investments REITs can make and how REITs can generate income. REITs must invest at least 75% of their total assets in real estate assets and cash; they must derive at least 75% of their gross income from real estate related sources, including rents from real property and interest on mortgages financing real property; they must derive at least 95% of their gross income from such real estate sources and dividends or interest from any source; and they must have no more than 25% of their assets consist of non-qualifying securities or stock in taxable

[7] 17 C.F.R. § 270.12b-1. Rule 12b-1 fees can be used to pay for distribution and/or shareholder servicing. Under FINRA Rule 2341, up to 75 basis points of this fee may be for distribution and up to 25 basis points may be for shareholder services with an effective annual cap of 100 basis points for Rule 12b-1 fees.

[8] Pursuant to multi-class exemptive orders, many Interval Funds offer multiple classes of shares that include distribution fees and/or shareholder servicing fees that are similar to Rule 12b-1 fees.

[9] We acknowledge that FINRA Rule 2341 caps shareholder servicing fees at 25 basis points annually.

REIT subsidiaries. These requirements force REITs to invest in income producing real estate-related assets and to automatically distribute that income to stockholders, unlike regular corporations that can be operated for any lawful purpose and are not required to make distributions to their stockholders.

PLRs, which are continuously offered, are also continually subject to the NASAA REIT Guidelines and the disclosure requirements under the Securities Act, unlike regular corporations. In addition to owing duties to the PLR and its stockholders under state corporate law, the board of directors of a PLR has specifically enumerated responsibilities under the NASAA REIT Guidelines. The board of directors:

(1) Must have a minimum of three directors, a majority of which must be independent directors, and all of which must have had at least three years of relevant experience acquiring and managing the type of assets being acquired by the REIT, and at least one of the independent trustees must have three years of relevant real estate experience;

(2) Must take on a specific fiduciary duty to the stockholders to supervise the relationship with the REIT's external advisor;

(3) Must establish written policies on investments and borrowing and monitor the administrative procedures, investment operations and performance of the REIT and the advisor to ensure such polices are carried out;

(4) Must annually review the performance, qualifications and compensation of the advisor based on enumerated factors under the NASAA REIT Guidelines; and

(5) Must at least annually determine (with a majority of the independent directors concurring) that the total fees and expense of the REIT are reasonable in light of the investment performance of the REIT, its net assets, its net income and the fees and expenses of other comparable unaffiliated REITs, and each such determination must be reflected in the minutes of the board of directors.

A PLR's advisor and sponsor must also make additional commitments to the PLR, unlike typical corporations that may not have the ongoing support and expertise of larger, experienced entities. The advisor is required to agree to be a fiduciary to the REIT and its stockholders, and the advisor's contract, qualifications, payment and performance must be reviewed annually by the board of directors. The sponsor is also required to make an initial contribution to the REIT not less than $200,000.[10] The sponsor may not sell this investment while the sponsor remains the sponsor (although it may transfer the interest to an affiliate), in order to align its interests with those of the stockholders. Unlike traditional corporations that may have no minimum investment requirements or protections, the sponsor must propose a minimum income and net worth standard that is reasonable given the type of REIT and the risks associated with the purchase of the shares. Minimum suitability amounts are an annual gross income of $70,000 and a minimum net worth of $70,000 or a minimum net worth of $250,000, and net worth must be determined exclusive of home, home furnishings and automobiles. In addition to the minimum suitability amounts, the sponsor and each person selling shares must make every reasonable effort to determine that the purchase of shares is a suitable and appropriate investment for each stockholder by ascertaining that the stockholder meets the minimum income and net worth standards established; can reasonably benefit from the investment based on the stockholder's overall investment objectives and portfolio structure; is able to bear the economic risk of the investment based on the prospective stockholder's overall financial situation; and that the stockholder has an apparent understanding of (1) the fundamental risk of the investment, (2) the risk that the stockholder

[10] While a $200,000 investment is required, PLR sponsors generally invest in substantially greater amounts. Jones Lang LaSalle Incorporated, for example, has made a $50 million investment in JLL Income Property Trust.

may lose the entire investment, (3) the lack of liquidity of the shares, (4) the restrictions on transferability and (5) the tax consequences of investment. The sponsor and each person selling shares must obtain information from the stockholder in order to make this determination and must keep the information used to determine that an investment is suitable and appropriate for six years. These suitability requirements provide additional protections to the stockholders of PLRs that are not necessarily required for investors in regular corporations.

Stockholders of PLRs also are guaranteed certain voting rights under the NASAA REIT Guidelines, including the right to amend the declaration of trust, terminate the REIT and remove directors on a majority vote. Without a majority of the outstanding shares, the board of directors may not amend the charter to adversely affect the rights of the stockholders, sell all or substantially all of the REIT's assets, cause the merger or other reorganization of the REIT, or to dissolve or liquidate the REIT. The NASAA REIT Guidelines also provide for certain voting and appraisal rights in connection with any roll-up transaction. Stockholders are entitled to annual reports including certain disclosures related to capital raised, fees, affiliated transactions and whether the independent directors have determined that the REIT's policies are in the best interest of stockholders and must have appropriate access to records. These items are in addition to the corporate requirements under state law and the disclosures required in the PLR's offering documents under the Securities Act and the ongoing disclosure requirements of the Securities and Exchange Act of 1934, as amended.

PLRs also have additional restrictions under the NASAA REIT Guidelines on the fees that can be paid in connection with their operations and common transactions. These are additional restrictions over regular corporations and even publicly-listed REITs or private REITs, which are not subject to the NASAA REIT Guidelines. On an ongoing basis, the PLR's total operating expenses may not be greater than 2% of the average invested assets or 25% of the net income for each year, and the aggregate borrowings of the PLR must be reasonable in relation to its net assets and reviewed quarterly by the board of directors. The PLR's borrowings in relation to its net assets also generally must not exceed 300%. With respect to each continuous offering of the PLR, organization and offering expenses may not exceed 15% of the proceeds raised. Any incentive fees paid by the PLR should generally not exceed 15% of the balance of proceeds once stockholders have received a return of their initial capital and an amount equal to 6% of the original price of the shares per annum cumulative. The NASAA REIT Guidelines also provide additional restrictions on fees paid to affiliates and the types of options or warrants issuable to affiliates in order to prevent dilution of the stockholders' interests.

FINRA's Proposed Change of the Treatment of Continuously Offered Tender Offer Funds Suggests that a Fundamental Policy is no Longer Required

We note that the National Association of Securities Dealers ("NASD"), predecessor to FINRA, determined in NASD Notice to Members 00-53[11] that continuously offered Interval Funds should be exempt from the filing requirements and limitations on underwriting compensation of the Corporate Financing Rule (formerly NASD Rule 2710) and instead, similar to Open-End Funds, should be subject to the sales charge limitations of NASD Rule 2830 (now FINRA Rule 2341). At the time of Notice to Members 00-53, NASD had long applied the Corporate Financing Rule to Closed-End Funds, including continuously offered Interval Funds, on the basis that Closed-End Fund offerings were structured and marketed in a manner that was more similar to and competitive with corporate securities offerings than to Open-End Funds.[12] NASD determined, however, that, as the distribution of continuously offered Interval Fund shares was conducted and financed in a manner more similar to that used by Open-End Funds than the method used by traditional

[11] Jun. 20, 2000 (available at http://www.finra.org/industry/notices/00-53).

[12] Securities Exchange Act Release No. 42965 (June 20, 2000); 65 F.R. 39640 (June 27, 2000).

Closed-End Funds, the sales charge limitations of NASD Rule 2830 were more appropriate for continuously offered Interval Funds.[13]

At the time of NASD Notice to Members 00-53, while NASD exempted continuously offered Interval Funds from the filing requirements and limitations on underwriting compensation of the Corporate Financing Rule, and instead subjected continuously offered Interval Funds to the sales charge limitations of NASD Rule 2830, NASD declined to grant the same relief to continuously offered Tender Offer Funds.[14] NASD's reason for declining to grant similar relief to continuously offered Tender Offer Funds was that continuously offered Tender Offer Funds, unlike continuously offered Interval Funds, did not have an equivalent fundamental policy requiring that they make periodic repurchases.[15] NASD further reasoned that the discretion afforded to continuously offered Tender Offer Funds as to whether or not they made periodic repurchases allowed such continuously offered Tender Offer Funds the ability to determine if they needed to continuously offer shares to replenish fund assets, which could in turn allow such continuously offered Tender Offer Funds to compensate broker/dealers in a manner similar to corporate issuers.[16]

As noted above, in FINRA Regulatory Notice 17-15, FINRA has proposed amendments to the Corporate Financing Rule that include adding follow-on offerings of Tender Offer Funds that routinely make self-tender offers and need to be in continuous distribution to offset net redemptions to the list of offerings exempt from the filing requirements of the Corporate Financing Rule, although they would remain subject to the Corporate Financing Rule's prohibitions on unreasonable underwriting terms and arrangements. The proposed amendments would instead make compensation for the distribution of continuously offered Tender Offer Funds subject to the limitations of FINRA Rule 2341. FINRA's proposed amendments to the Corporate Financing Rule would apply to a Tender Offer Fund that: (i) makes continuous offerings pursuant to Securities Act Rule 415; (ii) prices its securities monthly; (iii) limits the total amount of compensation paid to participating members to the amount permitted by the sales charge limitations of Rule 2341, in which case the underwriting compensation provisions of the Corporate Financing Rule would not apply; (iv) makes at least two repurchase offers per calendar year; (v) does not list its securities on an exchange; and (vi) files its initial public offering of equity with FINRA.

Most notably, the proposed amendments do not require that Tender Offer Funds have a fundamental policy regarding periodic repurchases, like Interval Funds, to be subject to FINRA Rule 2341 rather than the Corporate Financing Rule. Continuously offered Interval Funds would merely have to make two repurchase offers in a calendar year. While PLRs, like Tender Offer Funds, do not have a fundamental policy that they will make periodic repurchases, PLRs would typically make repurchases even more frequently (daily or monthly) than continuously offered Tender Offer Funds would be required under the proposed amendments.

Similar Treatment for Similarly Offered and Sold Investment Products

We believe that, for purposes of the Corporate Financing Rule, continuously offered PLRs more closely resemble Open-End Funds, continuously offered Interval Funds and continuously offered Tender Offer Funds ("Continuously Offered Investment Companies") than traditional non-listed REITs. That is, the distribution and compensation arrangements for and liquidity features of continuously offered PLRs are very similar to Continuously Offered Investment Companies. Additionally, we believe that PLRs offer

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[13] *See id.* at 39642.

[14] *See id.*

[15] *See id.*

[16] *See id.*

considerable benefits to investors over traditional non-listed REITs, including: (i) providing investors the flexibility to increase or decrease their investments in the PLR as their individual situations change; (ii) minimizing the risk that their long-term investment goals will conflict with short-term liquidity needs; (iii) allowing investors to seek returns of their capital and monetize any investment gain at a time of their choice, rather than being forced to wait for a terminal liquidity event outside of their control; (iv) aligning financial advisors' incentives with investors goals and providing additional incentives for financial advisors' to continue to expand the stockholder base, thus continuing to lower the costs to individual stockholders over time; and (v) lowering fees overall, which PLRs believe will lead to greater returns over time.

As PLRs are highly regulated like Continuously Offered Investment Companies, although not by the 1940 Act, and as Regulatory Notice 17-15 seems to suggest that a fundamental policy regarding periodic repurchases is no longer a requirement, we believe that, given the similarities of how continuously offered PLR shares are structured, offered and sold compared to how shares of Continuously Offered Investment Companies are structured, offered and sold, as well as the benefits offered investors in PLRs as compared to traditional non-listed REITs, continuously offered PLRs should be afforded the same treatment as FINRA currently proposes to take with continuously offered Tender Offer Funds.

Accordingly, consistent with the goal of modernizing FINRA rules to reflect changes in the industry (and in this case, the development of a new type of non-listed REIT that is designed to be more favorable to investors than traditional non-listed REITs), we request that FINRA revise the Corporate Financing Rule and FINRA Rule 2310 to exempt continuously offered PLRs from their requirements and instead subject such PLRs to the requirements of FINRA Rule 2341. Alternatively, we request that FINRA Rule 2310 be amended to provide sales charge limits similar to FINRA Rule 2341 for continuously offered PLRs and, in particular, exclude trailing fees paid for ongoing stockholder services from such limits.

* * *

Once again, we appreciate the opportunity to submit these comments.

Sincerely,

C. Allan Swaringen
Chief Executive Officer
Jones Lang LaSalle Income Property Trust, Inc.

Jon E. Abrahamovich
Head of Intermediary Distribution
LaSalle Investment Management Distributors, LLC

EXHIBIT 4

Exhibit 4 shows this proposed rule change as if adopted.

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2300. SPECIAL PRODUCTS

2310. Direct Participation Programs

(a) Definitions

For the purposes of this Rule, the following terms shall have the stated meanings:

(1) Affiliate — when used with respect to a member or sponsor, shall mean any person which controls, is controlled by, or is under common control with, such member or sponsor and includes:

(A) any partner, officer or director (or person performing similar functions) of (i) such member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor;

(B) any person which beneficially owns or has the right to acquire 10% or more of the equity interest in or has the power to vote 10% or more of the voting interest in (i) such member or sponsor, or (ii) a person which beneficially owns 50% or more of the equity interest in, or has the power to vote 50% or more of the voting interest in, such member or sponsor;

(C) any person with respect to which such member or sponsor, the persons specified in subparagraph (A) or (B), and the immediate families of partners, officers or directors (or persons performing similar functions) specified in subparagraph (A), or other person specified in subparagraph (B), in the aggregate beneficially own or have the right to acquire 10% or more of the equity interest or have the power to vote 10% or more of the voting interest;

(D) any person an officer of which is also a person specified in subparagraph (A) or (B) and any person a majority of the board of directors of which is comprised of persons specified in subparagraph (A) or (B); or

(E) any person controlled by a person or persons specified in subparagraphs (A), (B), (C) or (D).

(2) Cash available for distribution — cash flow less amount set aside for restoration or creation of reserves.

(3) Cash flow — cash funds provided from operations, including lease payments on net leases from builders and sellers, without deduction for depreciation, but after deducting cash funds used to pay all other expenses, debt payments, capital improvements and replacements.

(4) Direct participation program (program) — a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, real estate programs, agricultural programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. A program may be composed of one or more legal entities or programs but when

used herein and in any rules or regulations adopted pursuant hereto the term shall mean each of the separate entities or programs making up the overall program and/or the overall program itself. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company including separate accounts, registered pursuant to the Investment Company Act.

(5) Dissenting limited partner — a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by FINRA, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under FINRA rules during the period in which the offer is outstanding. Such objection in writing shall be filed with the party responsible for tabulating the votes or tenders.

(6) Equity interest — when used with respect to a corporation, means common stock and any security convertible into, exchangeable or exercisable for common stock, and, when used with respect to a partnership, means an interest in the capital or profits or losses of the partnership.

(7) Fair market net worth — total assets computed at fair market value less total liabilities.

(8) Limited partner or investor in a limited partnership — the purchaser of an interest in a direct participation program that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability.

(9) Limited partnership — an unincorporated association that is a direct participation program organized as a limited partnership whose partners are one or more general partners and one or more limited partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

(10) Limited partnership rollup transaction — a transaction involving the combination or reorganization of one or more limited partnerships, directly or indirectly, in which:

(A) some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(B) any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(C) investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

(D) any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue. Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

(i) a transaction that involves only a limited partnership or partnerships having an operating policy or practice of retaining cash available for distribution and reinvesting proceeds from the sale, financing, or refinancing of assets in accordance with such criteria as the SEC determines appropriate;

(ii) a transaction involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the original limited partnership;

(iii) a transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act;

(iv) a transaction that involves only issuers that are not required to register or report under Section 12 of the Exchange Act, both before and after the transaction;

(v) a transaction, except as the SEC may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

a. such action is approved by not less than 66 2/3 percent of the outstanding units of each of the participating limited partnerships; and

b. as a result of the transaction, the existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

(vi) a transaction, except as the SEC may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act; if:

a. such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

b. the securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(vii) a transaction involving only entities registered under the Investment Company Act or any Business Development Company as defined in Section 2(a)(48) of that Act.

(11) Management fee — a fee paid to the sponsor, general partner(s), their affiliates, or other persons for management and administration of a direct participation program.

(12) Organization and offering expenses — expenses incurred in preparing a direct participation program for registration and subsequently offering interests in the program to the public, including all forms of compensation paid to underwriters, broker-dealers, or affiliates thereof in connection with the offering of the program.

(13) Participant — the purchaser of an interest in a direct participation program.

(14) Person — any natural person, partnership, corporation, association or other legal entity.

(15) Prospectus — a prospectus as defined by Section 2(10) of the Securities Act, as amended, an offering circular as described in Securities Act

Rule 256 or, in the case of an intrastate offering, any document utilized for the purpose of announcing the offer and sale of securities to the public.

(16) Registration statement — a registration statement as defined by Section 2(8) of the Securities Act, as amended, a notification on Form 1-A filed with the SEC pursuant to the provisions of Securities Act Rule 255 and, in the case of an intrastate offering, any document initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any state.

(17) Solicitation expenses — direct marketing expenses incurred by a member, in connection with a limited partnership rollup transaction such as telephone calls, broker-dealer fact sheets, members' legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

(18) Sponsor — a person who directly or indirectly provides management services for a direct participation program whether as general partner, pursuant to contract or otherwise.

(19) Transaction costs — costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

(b) Requirements

(1) Application

No member or person associated with a member shall participate in a public offering of a direct participation program, a limited partnership rollup transaction or, where expressly provided below, a real estate investment trust as defined in Rule 2231(d)(4) ("REIT"), except in accordance with this paragraph (b).

(2) Suitability

(A) A member or person associated with a member shall not underwrite or participate in a public offering of a direct participation program unless standards of suitability have been established by the program for participants therein and such standards are fully disclosed in the prospectus and are consistent with the provisions of subparagraph (B).

(B) In recommending to a participant the purchase, sale or exchange of an interest in a direct participation program, a member or person associated with a member shall:

(i) have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member or associated person, that:

a. the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;

b. the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and

c. the program is otherwise suitable for the participant; and

(ii) maintain in the files of the member documents disclosing the basis upon which the determination of suitability was reached as to each participant.

(C) Notwithstanding the provisions of subparagraphs (A) and (B) hereof, no member shall execute any transaction in direct participation program in a discretionary account without prior written approval of the transaction by the customer.

(D) Subparagraphs (A) and (B), and, only in situations where the member is not affiliated with the direct participation program, subparagraph (C) shall not apply to:

(i) a secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program that is listed on a national securities exchange; or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for listing on a national securities exchange has been approved by such exchange and the applicant makes a good faith representation that it believes such listing on an exchange will occur within a reasonable period of time following the formation of the program.

(3) Disclosure

(A) Prior to participating in a public offering of a direct participation program or REIT, a member or person associated with a member shall have reasonable grounds to believe, based on information made available to him by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

(B) In determining the adequacy of disclosed facts pursuant to subparagraph (A) hereof, a member or person associated with a member shall obtain information on material facts relating at a minimum to the following, if relevant in view of the nature of the program:

(i) items of compensation;

(ii) physical properties;

(iii) tax aspects;

(iv) financial stability and experience of the sponsor;

(v) the program's conflict and risk factors; and

(vi) appraisals and other pertinent reports.

(C) For purposes of subparagraphs (A) or (B) hereof, a member or person associated with a member may rely upon the results of an inquiry conducted by another member or members, provided that:

(i) the member or person associated with a member has reasonable grounds to believe that such inquiry was conducted with due care;

(ii) the results of the inquiry were provided to the member or person associated with a member with the consent of the member or members conducting or directing the inquiry; and

(iii) no member that participated in the inquiry is a sponsor of the program or an affiliate of such sponsor.

(D) Prior to executing a purchase transaction in a direct participation program or a REIT, a member or person associated with a member shall inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program or REIT during the term of the investment. Included in the pertinent facts shall be information regarding whether the sponsor has offered prior programs or REITs in which disclosed in the offering materials was a date or time period at which the program or REIT might be liquidated, and whether the prior program(s) or REIT(s) in fact liquidated on or around that date or during the time period; provided however, this subparagraph (D) shall not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a direct participation program that meets the criteria in paragraph (b)(2)(D)(i) or (ii).

(4) Organization and Offering Expenses

(A) No member or person associated with a member shall underwrite or participate in a public offering of a direct participation program or REIT if the organization and offering expenses are not fair and reasonable, taking into consideration all relevant factors.

(B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed to be unfair and unreasonable if:

(i) organization and offering expenses, as defined in paragraph (b)(4)(C), in which a member or an affiliate of a member is a sponsor, exceed an amount that equals fifteen percent of the gross proceeds of the offering;

(ii) the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail commissions," payable to underwriters, broker-dealers, or affiliates thereof exceeds an amount that equals ten percent of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends);

(iii) any compensation in connection with an offering is to be paid to underwriters, broker-dealers, or affiliates thereof out of the proceeds of the offering prior to the release of such proceeds from escrow, provided, however, that any such payment from sources other than proceeds of the offering shall be made only on the basis of bona fide transactions;

(iv) commissions or other compensation are to be paid or awarded either directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program or REIT, unless such person is a registered broker-dealer or a person associated with such a broker-dealer;

(v) the program or REIT provides for compensation of an indeterminate nature to be paid to members or persons associated with members for sales of the program or REIT, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, an over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items;

(vi) the program or REIT charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act became effective prior to August 6, 2008; or

(vii) the member has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

(C) The organization and offering expenses subject to the limitations in paragraph (b)(4)(B)(i) above include the following:

(i) issuer expenses that are reimbursed or paid for with offering proceeds, including overhead expenses, which issuer expenses include, but are not limited to, expenses for:

a. assembling, printing and mailing offering materials, processing subscription agreements, generating advertising and sales materials;

b. legal and accounting services provided to the sponsor or issuer;

c. salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer;

d. transfer agents, escrow holders depositories, engineers and other experts; and

e. registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees;

(ii) underwriting compensation as defined in Rule 5110(j)(22) including payments:

a. to any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities;

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering, except to the extent that such compensation has been included in a. above;

c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities, except:

1. to the extent that such compensation has been included in a. above;

2. for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and

3. for a registered representative whose sales activities are *de minimis* and incidental to his or her clerical or ministerial job functions; or

d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

(iii) due diligence expenses incurred when a member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document.

(D) Notwithstanding paragraphs (b)(4)(C)(ii)b. and c. above, for every program or REIT filed with the Corporate Financing Department (the "Department") for review, the Department shall, based upon the information provided, make a determination as to whether some portion of a registered representative's non-transaction-based compensation should not be deemed to be underwriting compensation if the registered representative is either:

(i) a dual employee of a member and the sponsor, issuer or other affiliate with respect to a program or REIT with ten or fewer registered representatives engaged in wholesaling, in which instance the Department may make such determination with respect to the ten or fewer registered representatives engaged in wholesaling; or

(ii) a dual employee of a member and the sponsor, issuer or other affiliate who is one of the top ten highest paid executives based on non-transaction-based compensation in any program or REIT.

(E) All items of compensation paid by the program or REIT directly or indirectly from whatever source to underwriters, broker-dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description, which are deemed to be in connection with or related to the public offering, shall be taken into consideration in computing the amount of compensation for purposes of determining compliance with the provisions of subparagraphs (A) and (B).

(F) The determination of whether compensation paid to underwriters, broker-dealers, or affiliates thereof is in connection with or related to a public offering, for purposes of this subparagraph (4), shall be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the member or affiliate in the organization, management and direction of the enterprise in which the sponsor is involved.

(i) An affiliate of a member which acts or proposes to act as a general partner, associate general partner, or other sponsor of a program or REIT shall be presumed to be bearing investment risk for purposes of this paragraph (b) if the affiliate:

a. is subject to potential liability as a general partner to the same extent as any other general partner;

b. is not indemnified against potential liability as a general partner to any greater or different extent than any other general partner for its actions or those of any other general partner;

c. has a net worth equal to at least five percent of the net proceeds of the public offering or $1.0 million, whichever is less; provided, however, that the computation of the net worth shall not include an interest in the program offered but may include net worth applied to satisfy the requirements of this paragraph (b) with respect to other programs or REITs; and

d. agrees to maintain net worth as required by subparagraph c. above under its control until the earlier of the removal or withdrawal of the affiliate as a general partner, associate general partner, or other sponsor, or the dissolution of the program or REIT.

(ii) For purposes of determining the factors to be utilized in computing compensation derived from securities received in connection with a public offering, the guidelines set forth in Rule 5110 shall govern to the extent applicable.

(G) Subject to the limitations on direct and indirect non-cash compensation provided under subparagraph (C), no member shall accept any cash compensation unless all of the following conditions are satisfied:

(i) all compensation is paid directly to the member in cash and the distribution, if any, of all compensation to the member's associated persons is controlled solely by the member;

(ii) the value of all compensation to be paid in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B);

(iii) arrangements relating to the proposed payment of all compensation are disclosed in the prospectus or similar offering document;

(iv) the value of all compensation paid in connection with an offering is reflected on the books and records of the recipient member as compensation received in connection with the offering; and

(v) no compensation paid in connection with an offering is directly or indirectly related to any non-cash compensation or sales incentive items provided by the member to its associated persons.

(5) Valuation for Customer Account Statements

A member shall not participate in a public offering of the securities of a direct participation program (DPP) that is not subject to the requirements of the Investment Company Act of 1940 or of a REIT unless the issuer of the DPP or REIT has agreed to disclose:

(A) a per share estimated value of the DPP or REIT security, developed in a manner reasonably designed to ensure it is reliable, in the DPP or REIT periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act;

(B) an explanation of the method by which the per share estimated value was developed;

(C) the date of the valuation; and

(D) in a periodic or current report filed pursuant to Section 13(a) or 15(d) of the Exchange Act within 150 days following the second anniversary of breaking escrow and in each annual report thereafter, a per share estimated value:

(i) based on valuations of the assets and liabilities of the DPP or REIT performed at least annually, by, or with the material assistance or confirmation of, a third-party valuation expert or service;

(ii) derived from a methodology that conforms to standard industry practice; and

(iii) accompanied by a written opinion or report by the issuer, delivered at least annually, that explains the scope of the review, the methodology used to develop the valuation or valuations, and the basis for the value or values reported.

(6) Participation in Rollups

(A) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction, irrespective of the form of the resulting entity (i.e., a partnership, real estate investment trust or corporation), unless any compensation received by the member:

(i) is payable and equal in amount regardless of whether the limited partner votes affirmatively or negatively in the proposed limited partnership rollup transaction;

(ii) in the aggregate, does not exceed 2% of the exchange value of the newly created securities; and

(iii) is paid regardless of whether the limited partners reject the proposed limited partnership rollup transaction.

(B) No member or person associated with a member shall participate in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction unless the general partner(s) or sponsor(s) proposing the limited partnership rollup transaction agrees to pay all solicitation expenses related to the limited partnership rollup transaction, including all preparatory work related thereto, in the event the limited partnership rollup transaction is rejected.

(C) No member or person associated with a member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program that values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely tradeable securities; provided, however, that:

1. limited partnership rollup transactions which utilize debt instruments as compensation must provide for a trustee and an indenture to protect the rights of the debt holders and provide a rate of interest equal to at least 120% of the applicable federal rate as determined in accordance with Section 1274 of the Internal Revenue Code of 1986;

2. limited partnership rollup transactions which utilize unsecured debt instruments as compensation, in addition to the requirements of subparagraph 1., must limit total leverage to 70% of the appraised value of the assets;

3. all debt securities must have a term no greater than 8 years and provide for prepayment with 80% of the net proceeds of any sale or refinancing of the assets previously owned by the partnership entitles subject to the limited partnership rollup transaction or any part thereof; and

4. freely tradeable securities used as compensation to dissenting limited partners must be previously listed on a national securities exchange prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be used as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided,

however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph.

b. to receive or retain a security with substantially the same terms and conditions as the security originally held. Securities received or retained will be considered to have the same terms and conditions as the security originally held if:

1. there is no material adverse change to dissenting limited partners' rights with respect to the business plan or the investment, distribution and liquidation policies of the limited partnership; and

2. the dissenting limited partners receive substantially the same rights, preferences and priorities as they had pursuant to the security originally held; or

c. to receive other comparable rights including, but not limited to:

1. approval of the limited partnership rollup transaction by 75% of the outstanding units of each of the individual participating limited partnerships and the exclusion of any individual limited

partnership from the limited partnership rollup transaction which fails to reach the 75% threshold. The third-party appointed to tabulate votes and dissents pursuant to subparagraph (C)(ii)b.4. hereof shall submit the results of such tabulation to FINRA;

2. review of the limited partnership rollup transaction by an independent committee of persons not affiliated with the general partner(s) or sponsor. Whenever utilized, the independent committee:

A. shall be approved by a majority of the outstanding securities of each of the participating partnerships;

B. shall have access to the books and records of the partnerships;

C. shall prepare a report to the limited partners subject to the limited partnership rollup transaction that presents its findings and recommendations, including any minority views;

D. shall have the authority to negotiate the proposed transaction with the general partner or sponsor on behalf of the limited partners, but not the authority to approve the transaction on behalf of the limited partners;

E. shall not deliberate for a period longer than 60 days, although extensions will be permitted if unanimously agreed upon by the members of the independent committee or if approved by FINRA;

F. may be compensated and reimbursed by the limited partnerships subject to the limited partnership rollup transaction and shall have the ability to retain independent counsel and financial advisors to represent all limited partners at the limited partnerships' expense provided the fees are reasonable; and

G. shall be entitled to indemnification to the maximum extent permitted by law from the limited partnerships subject to the limited partnership rollup transaction from claims, causes of action or lawsuits related to any action or decision made in furtherance of their responsibilities; provided, however, that general partners or sponsors may also agree to indemnify the independent committee; or

3. any other comparable rights for dissenting limited partners proposed by general partners or sponsors, provided, however, that the general partner(s) or sponsor demonstrates to the satisfaction of FINRA or, if FINRA determines appropriate, to the satisfaction of an independent committee, that the rights proposed are comparable.

(ii) Regardless of whether a limited partnership rollup transaction is in compliance with subparagraph (C)(i), a limited partnership rollup transaction will be presumed to be unfair and unreasonable:

a. if the general partner(s):

1. converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally

obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);

2. fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or

3. utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest, as determined by an appraisal conducted in a manner consistent with subparagraph (C)(i)a., when determining their interest in the new entity;

b. as to voting rights, if:

1. the voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if FINRA determines that such changes are not unfair or if the changes are approved by an independent committee;

2. a majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with applicable state law, vote to:

A. amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;

B. dissolve the entity;

C. remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or

D. approve or disapprove the sale of substantially all of the assets of the entity;

3. the general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which instructs the limited partner on the proper

procedure for voting against or dissenting from the transaction; or

4. the general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs;

c. as to transaction costs, if:

1. transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:

A. the general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and

B. limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or

2. individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships; or

d. as to fees of general partners, if:

1. general partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;

2. property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would

be paid to third parties for performing similar services; or

3. changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

(c) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" for the purposes of this paragraph (c) shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of direct participation securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

(2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation program or REIT securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors[1] and are not conditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (c)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean a United States office of the offeror or the member holding the meeting, or a facility located in the vicinity of such office, or a United States regional location with respect to meetings of associated persons who work within that region or, with respect to meetings with direct participation programs or REITs, a United States location at which a significant or representative asset of the program or REIT is located;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (c)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (c)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (c)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraph (c)(2)(C) through (E).

(d) Exemptions

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

* * * * *

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) Requirements for Public Offerings

(1) General

(A) No member or person associated with a member shall participate in a public offering in which the terms and conditions relating thereto, including the aggregate amount of underwriting compensation, are unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any rule or regulation of FINRA.

(B) Any member acting as a managing underwriter or in a similar capacity must notify the other members participating in the public offering if informed of an opinion by FINRA that the underwriting terms and arrangements are unfair and unreasonable and the proposed terms and arrangements have not been appropriately modified.

(C) No member may engage in the distribution or sale of securities in any public offering required to be filed by this Rule, Rule 2310 or Rule 5121 unless:

(i) documents and information specified in paragraph (a)(4) have been filed with FINRA; and

(ii) FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.

(2) Offerings Required to be Filed

All public offerings in which a member participates must be filed with FINRA for review, except as exempted from the filing requirement under paragraph (h).

(3) Timely Filing Requirements

(A) A member that participates in a public offering that is required to be filed under paragraph (a)(2) must file the documents and information specified in paragraph (a)(4):

(i) no later than three business days after any documents are filed with or submitted to:

a. the SEC, including confidential filings or submissions; or

b. any state securities commission or other similar U.S. regulatory authority; or

(ii) if not filed with or submitted to any such regulatory authority, at least 15 business days prior to the commencement of sales.

(B) A member that participates in a public offering is not required to make a filing if the filing has been made by a member that is responsible for managing the offering or by another member that is in the syndicate or selling group.

(4) Documents and Information Required to be Filed

(A) The following documents required to be filed under paragraph (a) must be filed in FINRA's Public Offering System for review by providing the SEC document identification number if available:

(i) the registration statement, offering circular, offering memorandum, notification of filing, notice of intention, application for conversion, and any other document used to offer securities to the public;

(ii) all documents relevant to the underwriting terms and arrangements, including any proposed underwriting agreement, agreement among underwriters, selected dealer's agreement, agency agreement, purchase agreement, letter of intent, engagement letter, consulting agreement, partnership agreement, underwriter's warrant agreement, or escrow agreement, provided that industry-standard master forms of agreement need not be filed unless otherwise specifically requested by FINRA;

(iii) if amendments to any documents previously filed contain changes that impact the underwriting terms and arrangements for the public offering, marked pages showing the changes to such document;

(iv) the final registration statement declared effective by the SEC, or the equivalent final offering document, the notice of effectiveness issued by the SEC or any other U.S. regulatory authority, the executed form of the final distribution-related documents and any other document submitted to FINRA for review, each if applicable; and

(v) all requests for withdrawal filed with or submitted to the SEC or any other U.S. regulatory authority, including any correspondence submitted to the SEC for the withdrawal of confidential filings or submissions.

(B) Any member filing documents with FINRA pursuant to paragraph (a)(4)(A) must file the following information with respect to the offering in FINRA's Public Offering System:

(i) an estimate of the maximum public offering price;

(ii) an estimate of the maximum value for each item of underwriting compensation;

(iii) a representation as to whether any officer or director of the issuer and any beneficial owner of 5% or more of any class of the issuer’s equity and equity-linked securities is an associated person or affiliate of a participating member;

(iv) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:

a. non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering must be filed and also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price; and

b. non-convertible or non-exchangeable debt securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering.

(v) if applicable, a representation of compliance with all of the criteria for any exception from underwriting compensation provided in paragraph (d); and

(vi) a detailed explanation and all documents related to the modification of any information or representation previously provided to FINRA during the review period, whether or not FINRA has issued a no objections opinion.

(C) In the event an offering filed pursuant to this Rule is not completed according to the terms of an agreement entered into by the issuer and a participating member, any member receiving underwriting compensation must provide written notification to FINRA of all underwriting compensation received or to be received pursuant to paragraph (g)(5), including a copy of any agreement governing the arrangement.

(D) FINRA will provide confidential treatment to all documents and information filed pursuant to this Rule and use such documents and information solely for regulatory purposes.

(E) Notwithstanding paragraph (a)(4)(A) and (B), with respect to a shelf offering, the following documents and information must be filed in FINRA's Public Offering System for review:

(i) the registration statement number; and

(ii) if requested by FINRA, other documents and information set forth in paragraph (a)(4)(A) and (B).

(b) Disclosure Requirements for Underwriting Compensation

(1) A description of each item of underwriting compensation received or to be received by a participating member must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Any underwriting compensation consisting of a commission or discount to the public offering price must be disclosed on the cover page of the prospectus or similar document. If the underwriting compensation includes items

of compensation in addition to the commission or discount disclosed on the cover page of the prospectus or similar document, a footnote to the offering proceeds table on the cover page of the prospectus or similar document shall include a cross-reference to the section on distribution arrangements.

(c) Valuation of Underwriting Compensation

(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security

A participating member may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:

(A) the security received or the security underlying the warrant or convertible security received is identical either to the security offered to the public or to a security with a bona fide public market; or

(B) the security can be accurately valued, as required by paragraph (g)(1) of this Rule.

(2) Valuation of Non-Convertible Securities

Non-convertible securities received as underwriting compensation will have a compensation value based on:

(A) the difference between:

(i) either the market price per security on the date of acquisition, or, if no bona fide public market exists for the security, the public offering price per security; and

(ii) the per security cost;

(B) multiplied by the number of securities received or to be received as underwriting compensation;

(C) divided by the offering proceeds; and

(D) multiplied by one hundred.

(3) Valuation of Convertible Securities

Options, warrants or convertible securities ("warrants") shall have a compensation value based on the following formula:

(A) the public offering price per security multiplied by .65;

(B) minus the resultant of the exercise or conversion price per warrant less either:

(i) the market price per security on the date of acquisition, where a bona fide public market exists for the security, or

(ii) the public offering price per security;

(C) divided by two;

(D) multiplied by the number of securities underlying the warrants;

(E) less the total price paid for the warrants;

(F) divided by the offering proceeds; and

(G) multiplied by one hundred;

(H) provided, however, that, notwithstanding paragraph (c)(4) of this Rule, such warrants shall have a compensation value of at least .2% of the offering proceeds for each amount of securities that is up to 1% of the securities being offered to the public (excluding securities subject to an overallotment option).

(4) Reduction in Valuation

If a participating member wishes to reduce the proposed maximum value of any securities received as underwriting compensation, it may do so by voluntarily agreeing to lock-up such securities for successive 180-day periods (in addition to the initial lock-up period required by paragraph (e) of this Rule if applicable). Each additional 180-day period will reduce the proposed maximum value attributable to such securities by 10%.

(5) Valuation of Securities Acquired in Connection with a Fair Price Non-Convertible or Non-Exchangeable Debt or Derivative Instrument

Any non-convertible or non-exchangeable debt or derivative instrument acquired or entered into at a "fair price" as defined in Supplementary Material .06(b) and underwriting compensation received in or receivable in the settlement, exercise or other terms of such non-convertible non-exchangeable debt or derivative instrument shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the non-convertible or non-exchangeable debt or derivative instrument is not a fair price, compensation will be calculated pursuant to this paragraph (c) or based on the difference between the fair price and the actual price.

(d) Securities Acquisitions Not Considered Underwriting Compensation

Securities acquired in transactions that meet the requirements of this paragraph (d) are excluded from underwriting compensation and not subject to the lock-up requirements of paragraph (e)(1), provided that the member does not condition its participation in the public offering on an acquisition of securities in a transaction that meets the requirements of this paragraph and any securities acquired are acquired at the same price and with the same terms as the securities purchased by all other investors.

(1) Purchases and Loans by Certain Affiliates — Securities of the issuer purchased in a private placement or received as compensation in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph (a) by a participating member's affiliate, if:

(A) the affiliate is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(B) the investment or loan was made subject to the evaluation of individuals who have a contractual or fiduciary duty to select investments and loans based on the risks and rewards to the affiliate and not based on opportunities for the member participating in the offering to earn investment banking revenues;

(C) the affiliate does not receive investment banking fees paid to any participating member for underwriting public offerings;

(D) the affiliate, directly or through a subsidiary it controls, is primarily engaged in the business of making investments in or loans to other companies or is an entity that has been newly formed by such affiliate; and

(E) the affiliate either:

(i) manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;

(ii) manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;

(iii) is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or

(iv) is a bank.

(2) Investments in and Loans to Certain Issuers — Securities of the issuer purchased in a private placement or received as compensation in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph (a) by a participating member's affiliate if:

(A) the affiliate:

(i) manages capital contributions or commitments of at least $50 million;

(ii) is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(iii) does not receive investment banking fees paid to any participating member for underwriting public offerings; and

(iv) directly or through a subsidiary it controls, is primarily engaged in the business of making investments in or loans to other companies or is an entity that has been newly formed by such affiliate;

(B) institutional investors beneficially own at least 33% of the issuer's total equity securities, calculated immediately prior to the transaction; and

(C) the transaction was approved by a majority of the issuer's board of directors (if the issuer has a board of directors) and a majority of any institutional investors, or the designees of institutional investors, that are board members.

(3) Private Placements with Institutional Investors — Securities of the issuer purchased in, or received as compensation for services provided in connection with, a private placement before the required filing date of the public offering pursuant to paragraph (a) if:

(A) institutional investors, none of whom is an affiliate of a member participating in the offering, purchase at least 51% of the total number of securities sold in the private placement at the same time and on the same terms;

(B) an institutional investor was the lead negotiator or, if the terms were not negotiated, was the lead investor with the issuer to establish or approve the terms of the private placement; and

(C) the participating members did not, in the aggregate, purchase or receive as compensation more than 40% of the "total number of securities sold in the private placement" (excluding purchases by any affiliate qualified under paragraph (d)(1)).

(4) Co-Investments with Certain Regulated Entities — Securities of the issuer acquired in a private placement before the required filing date of the public offering pursuant to paragraph (a) by a participating member if at least 15% of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that is an open-end investment company not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering.

(e) Lock-Up Restriction on Securities

(1) Lock-Up Restriction

(A) Any underwriting compensation consisting of securities must not be sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities for a period of 180 days beginning on the date of commencement of sales of the public equity offering, except as provided in paragraph (e)(2).

(B) The lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (e)(1):

(A) the lock-up restriction will not apply:

(i) if the security is required to be transferred by operation of law or by reason of reorganization of the issuer;

(ii) if the aggregate amount of securities of the issuer beneficially owned by a participating member does not exceed 1% of the securities being offered;

(iii) to a security of an issuer that meets the registration requirements of SEC Registration Forms S-3, F-3 or F-10;

(iv) to a non-convertible or non-exchangeable debt security acquired in a transaction related to the public offering;

(v) to a derivative instrument acquired in connection with a hedging transaction related to the public offering and at a fair price;

(vi) if the security was acquired in a transaction that met the requirements of paragraph (d);

(vii) if the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that no participating member manages or otherwise directs investments by the fund, and participating members in the aggregate do not own more than 10% of the equity in the fund; or

(viii) if the security was received as underwriting compensation, and is registered and sold as part of a firm commitment offering.

(B) the following will not be prohibited:

(i) the transfer of any security to any member participating in the offering and its officers or partners, its registered persons or affiliates, if all transferred securities remain subject to the lock-up restriction in paragraph (e)(1) for the remainder of the 180-day lock-up period;

(ii) the exercise or conversion of any security, if all securities received remain subject to the lock-up restriction in paragraph (e)(1) for the remainder of the 180-day lock-up period; or

(iii) the transfer or sale of the security back to the issuer in a transaction exempt from registration with the SEC.

(f) Non-Cash Compensation

(1) Definitions

The terms “compensation,” “non-cash compensation” and “offeror” as used in this paragraph (f) shall have the following meanings:

(A) “Compensation” shall mean cash compensation and non-cash compensation.

(B) “Non-cash compensation” shall mean any form of compensation received in connection with the sale and distribution of securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors[1] and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a

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[1] The current annual amount fixed by the Board of Governors is $100.

sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph (f)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph (f)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph (f)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs (f)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraphs (f)(2)(C) through (E).

(g) Unreasonable Terms and Arrangements

Without limiting the requirements of paragraph (a)(1)(A), the following terms and arrangements are prohibited:

(1) receipt of any underwriting compensation, including in the form of securities, for which a value cannot be determined;

(2) any accountable expense allowance that includes payment for general overhead, salaries, supplies, or similar expenses incurred in the normal conduct of business;

(3) any non-accountable expense allowance in excess of 3% of offering proceeds;

(4) any underwriting compensation paid prior to the commencement of sales of the public offering, except:

(A) an advance against accountable expenses actually anticipated to be incurred, which must be reimbursed to the issuer to the extent not actually incurred; or

(B) advisory or consulting fees for services provided in connection with the offering that subsequently is completed according to the terms of an agreement entered into by an issuer and a participating member;

(5) any underwriting compensation in connection with a public offering that is not completed according to the terms of an agreement entered into by an issuer and a participating member, except:

(A) the reimbursement of accountable expenses actually incurred by the participating member; and

(B) a termination fee or a right of first refusal, as set forth in a written agreement entered into by an issuer and a participating member, provided that:

(i) the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement;

(ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal;

(iii) the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv) the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer;

(6) any right of first refusal to participate in the distribution of a future public offering, private placement or other financing that:

(A) has a duration of more than three years from the commencement of sales of the public offering or the termination date of the engagement between the issuer and member; or

(B) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee;

(7) any payment or fee to waive or terminate a right of first refusal to participate in a future public offering, private placement or other financing that is not paid in cash;

(8) the receipt of underwriting compensation consisting of any option, warrant or convertible security that:

(A) is exercisable or convertible more than five years from the commencement of sales of the public offering;

(B) has more than one demand registration right at the issuer's expense;

(C) has a demand registration right with a duration of more than five years from the commencement of sales of the public offering;

(D) has a piggyback registration right with a duration of more than seven years from the commencement of sales of the public offering;

(E) has anti-dilution terms that allow the participating members to receive more shares or to exercise at a lower price than originally agreed upon at the time of the public offering, when the public shareholders have not been proportionally affected by a stock split, stock dividend, or other similar event; or

(F) has anti-dilution terms that allow the participating members to receive or accrue cash dividends prior to the exercise or conversion of the security;

(9) when proposed in connection with the distribution of a public offering of securities on a "firm commitment" basis, any overallotment option providing for the overallotment of more than 15% of the amount of securities being offered, computed excluding any securities offered pursuant to the overallotment option;

(10) the receipt by a participating member of any compensation in connection with the exercise or conversion of any warrant, option, or convertible security offered in the public offering if:

(A) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

(B) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion, except where

prior specific written approval for exercise or conversion is received from the customer;

(C) the compensation arrangements are not disclosed in the offering documents provided to security holders at the time of exercise or conversion;

(D) the exercise or conversion is not solicited by the participating members; and

(11) for a member to participate with an issuer in the public offering of securities if the issuer hires persons primarily for the purpose of solicitation, marketing, distribution or sales of the offering, except in compliance with Section 15(a) of the Exchange Act or SEA Rule 3a4-1 and applicable state law.

(h) Exemptions

(1) Offerings Exempt from Filing

Documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of Rule 5121(a)(2), provided that the following public offerings must comply with this Rule and, if applicable, Rules 2310 and 5121:

(A) securities offered by a bank, corporate issuer, foreign government or foreign government agency that has unsecured non-convertible debt with a term of issue of at least four years or unsecured non-convertible preferred securities that are investment grade rated, as defined in Rule 5121(f)(8), or are securities in the same series that have equal rights and obligations as investment grade rated securities, provided that an initial public offering of equity is required to be filed;

(B) investment grade rated non-convertible debt securities and non-convertible preferred securities;

(C) offerings of securities registered with the SEC on registration statement Forms S-3, F-3, or F-10, provided that the registrant is an experienced issuer;

(D) investment grade rated financing instrument-backed securities;

(E) exchange offers where:

(i) the securities to be issued or the securities of the company being acquired are listed, or convertible into securities that are listed, on a national securities exchange as defined in Section 6 of the Exchange Act; or

(ii) the company issuing securities qualifies to register securities with the SEC on registration statement Forms S-3, F-3, or F-10 and is an experienced issuer;

(F) public offerings of securities by a church or other charitable institution that is exempt from SEC registration pursuant to Section 3(a)(4) of the Securities Act; and

(G) offerings of securities issued by a pooled investment vehicle, whether formed as a trust, partnership, corporation, limited liability company or other collective investment vehicle, that is not registered as an investment company under the Investment Company Act and has a class of equity securities listed for trading on a national securities exchange and that may be created or redeemed on any business day at their net asset value per share.

(2) Offerings Not Subject to Filing and Rule Compliance

The following offerings are not subject to this Rule, Rule 2310 and Rule 5121 including not being required to file documents and information for review:

(A) securities of "open-end" investment companies as defined in Section 5(a)(1) of the Investment Company Act;

(B) securities of any "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act and offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) of SEC Regulation C;

(C) variable contracts as defined in Rule 2320(b)(2);

(D) modified guaranteed annuity contracts and modified guaranteed life insurance policies, which are deferred annuity contracts or life insurance policies the value of which are guaranteed if held for specified periods, and the nonforfeiture value of which are based upon a market-value adjustment formula for withdrawals made before the end of any specified period;

(E) insurance contracts not otherwise included in paragraphs (h)(2)(C) and (D);

(F) municipal securities as defined in Section 3(a)(29) of the Exchange Act;

(G) tender offers made pursuant to SEC Regulation 14D under the Exchange Act;

(H) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act;

(I) securities of a subsidiary or other affiliate distributed by a company in a spin-off or reverse spin-off or similar transaction to its existing security holders exclusively as a dividend or other distribution;

(J) securities registered with the SEC in connection with a merger or acquisition transaction or other similar business combination, except for any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member;

(K) securities of a unit investment trust as defined in Section 4(2) of the Investment Company Act; and

(L) offerings of securities by a "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that is operated as a tender offer fund, provided that the fund:

(i) makes continuous offerings pursuant to Securities Act Rule 415;

(ii) prices its securities at least quarterly;

(iii) limits the total amount of compensation paid to participating members to the amount permitted by the sales charge limitations of Rule 2341, in which case the underwriting compensation provisions of Rule 5110 will not apply;

(iv) makes at least two repurchase offers per calendar year for its securities pursuant to SEA Rule 13e-4 and Schedule TO under the Exchange Act; and

(v) does not list its securities on a national securities exchange.

(i) Requests for Rule 9600 Exemption from Rule 5110

Pursuant to the Rule 9600 Series, FINRA, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest.

(j) Definitions

The definitions in Rule 5121 are incorporated herein by reference. For purposes of this Rule, the following terms have the meanings stated below:

(1) Associated Person

The term "associated person" has the meaning defined in Article I, Section (rr) of the FINRA By-Laws.

(2) Bank

The term "bank" means a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this

Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates.

(3) Company

The term "company" means a corporation, a partnership, an association, a joint stock company, a trust, a fund, or an organized group of persons whether incorporated or not; including any receiver, trustee in bankruptcy or similar official, or liquidating agent of any of the foregoing.

(4) Compensation

The term "compensation" means cash compensation and non-cash compensation.

(5) Effective Date

The term "effective date" means the date on which an issue of securities becomes legally eligible for distribution to the public.

(6) Experienced Issuer

The term "experienced issuer" means an entity that has:

(A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and

(B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

(7) Equity-Linked Securities

The term "equity-linked securities" means any security that is convertible or exchangeable into an equity security.

(8) Immediate Family

The term "immediate family" means:

(A) the spouse or child of an associated person of a member; and

(B) any relative who either lives in the same household as, has a business relationship with, provides material support to, or receives material support from, an associated person of a member, including, but not limited to, a parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

(9) Independent Financial Adviser

The term "independent financial adviser" means a member or a person affiliated or associated with a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated or associated with any entity that is engaged in, the solicitation or distribution of the offering.

(10) Institutional Investor

For the purposes of paragraph (d), the term "institutional investor" means any person that has an aggregate of at least $50 million invested in securities in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members manage the institutional investor's investments or have an equity interest in the institutional investor, either individually or in the aggregate, that exceeds 5% for a publicly owned entity or 1% for a nonpublic entity.

(11) Insurance Company

For the purposes of paragraph (d), the term "insurance company" refers only to the regulated entity, not its subsidiaries or other affiliates.

(12) Issuer

The term "issuer" means a registrant or other person that is offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant or such other person or selling security holder, and the officers or general partners, and directors thereof.

(13) Offering Proceeds

The term "offering proceeds" means the proceeds of all the securities offered in the public offering by participating members, not including securities subject to an overallotment option, securities to be received by the participating members, or underlying securities.

(14) Overallotment Option

The term "overallotment option" means an option granted by the issuer to the participating members for the purpose of offering additional shares to the public in connection with the distribution of the public offering.

(15) Participating Member

The term "participating member" means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer.

(16) Participate, Participation or Participating

The terms "participate," "participation" or "participating" in a public offering means involvement in the preparation of the offering document or other documents, involvement in the distribution of the offering, furnishing of customer or broker lists for solicitation, or providing advisory or consulting services to the issuer related to the offering, but do not include:

(A) the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEA Rule 13e-3; and

(B) advisory or consulting services provided to the issuer by an independent financial adviser, provided that another member or members is participating in the public offering.

(17) Person

The term "person" means any natural person, partnership, corporation, company, association, or other legal entity.

(18) Public Offering

The term "public offering" means any primary or secondary offering of securities made in whole or in part in the United States pursuant to a registration statement, offering circular or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition except for:

(A) securities exempt from registration with the SEC pursuant to the provisions of Sections 4(a)(1), 4(a)(2) or 4(a)(6) of the Securities Act;

(B) securities exempt from registration with the SEC pursuant to Rule 504 of SEC Regulation D if the securities are restricted securities under Securities Act Rule 144(a)(3) or Rule 506 of SEC Regulation D;

(C) securities exempt from registration with the SEC pursuant to Securities Act Rule 144A or SEC Regulation S; or

(D) securities which are defined as "exempted securities" in Section 3(a)(12) of the Exchange Act.

(19) Required Filing Date

(A) The term "required filing date" means the dates referenced in paragraph (a)(3); and

(B) For a public offering exempt from filing under paragraph (h), the term "required filing date" means the date the public offering would have been required to be filed with FINRA but for the exemption.

(20) Review Period

The term "review period" means:

(A) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering;

(B) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and

(C) for a firm commitment or best efforts takedown or any other continuous offering made pursuant to Securities Act Rule 415, the 180-

day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.

(21) Total Equity Securities

For the purposes of paragraph (d), the term "total equity securities" means the aggregate of the total shares of:

(A) common stock outstanding of the issuer; and

(B) common stock of the issuer underlying all convertible securities outstanding that convert without the payment of any additional consideration.

(22) Underwriting Compensation

The term "underwriting compensation" means 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. In addition, underwriting compensation shall include finder's fees, underwriter's counsel fees, and securities.

• • • Supplementary Material: --------------

.01 Underwriting Compensation

(a) The following are examples of payments or benefits that are considered underwriting compensation:

(1) discounts or commissions;

(2) fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses;

(3) fees and expenses of participating members' counsel paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement of "blue sky" fees);

(4) finder's fees paid or reimbursed to, or paid on behalf of, the participating members;

(5) wholesaling fees and expenses;

(6) financial consulting and advisory fees;

(7) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, beneficially owned, as defined in Rule 5121 by the participating members the value of which is determined pursuant to this Rule, and acquired during the review period, as defined in this Rule;

(8) sales incentive items;

(9) any right or rights of first refusal provided to any participating member to participate in future public offerings, private placements or other financings, the value of which will be 1% of the offering proceeds or a dollar amount contractually agreed to by the issuer and the participating member to waive the right of first refusal;

(10) compensation to be received by a participating member or by any person nominated by the participating member as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;

(11) any compensation to be received by the participating members as a result of the exercise or conversion of warrants, options, convertible securities, or similar securities distributed as part of the public offering within 12 months following the commencement of sales;

(12) fees of a qualified independent underwriter required by Rule 5121;

(13) any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering; and

(14) non-cash compensation, such as gifts, training and education expenses, sale incentives, and business entertainment expenses.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; fees of independent financial advisers; and accountant's fees, and other fees and expenses customarily borne by an issuer, whether or not paid by or through a participating member;

(2) cash compensation for providing services for a private placement or for providing or arranging for a loan, credit facility, or for services in connection with a merger or acquisition;

(3) records management and advisory fees and expenses in connection with the conversion of the issuer from a mutual holding company to a stock holding company;

(4) payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer;

(5) compensation for providing brokerage, trust and insurance services to the issuer that is received in the ordinary course of business;

(6) fees for commercial banking services that do not require registration as a broker-dealer, provided to the issuer in the ordinary course of business;

(7) compensation for providing services in a prior or concurrent public offering separately filed or exempt from filing pursuant to this Rule;

(8) a right of first refusal that is provided to a participating member in connection with a prior financing if the right of first refusal does not extend beyond the initial closing of the public offering currently under review or if the right of first refusal has already been included as underwriting compensation in a prior or concurrent public offering;

(9) dividends paid to shareholders of a class of the issuer's securities when participating members are shareholders of that class;

(10) securities of the issuer pledged as collateral for a bona fide loan;

(11) listed securities purchased in public market transactions;

(12) compensation received through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code or a similar plan;

(13) securities acquired by an investment company registered under the Investment Company Act;

(14) securities acquired as the result of a conversion of securities that were originally acquired prior to the review period;

(15) securities acquired as the result of an exercise of options or warrants that were originally acquired prior to the review period;

(16) securities acquired as the result of a stock-split, a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired prior to the review period;

(17) securities acquired as the result of a right of preemption that was granted prior to the review period;

(18) securities acquired in order to prevent dilution of a long-standing interest in the issuer, if:

(A) the amount of securities does not increase a member's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and

(B) an initial purchase of securities of the issuer was made at least two years preceding the required filing date and a second purchase was made before the review period;

(19) non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) securities acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A;

(21) securities acquired in the secondary market by a participating member that is a broker-dealer in connection with the performance of bona fide customer facilitation activities; provided that securities acquired from the issuer will be considered "underwriting compensation" if the securities were not acquired at a fair price (taking into account, among other things customary commissions, mark-downs and other charges); and

(22) securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding).

(c) Definitions

(1) The term "listed securities" means securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S.

(2) The term "right of pre-emption" means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to: (A) any option, shareholder agreement, or other contractual right entered into at the time of purchase of

securities; (B) the terms of the securities purchased; (C) the issuer's charter or by-laws; or (D) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.

.02 Venture Capital Transactions and Significantly Delayed Offerings. Notwithstanding paragraph (d), in the event that an offering is significantly delayed and the issuer needs funding pending consummation of the public offering, FINRA may exclude from underwriting compensation any securities acquired in a transaction that otherwise meets the requirements in paragraph (d), but occurs after the required filing date. To determine whether an acquisition of securities that occurs after the required filing date may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the length of time between the required filing of the registration statement or similar document and the date of the transaction in which securities were acquired;

(b) the length of time between the date of the transaction in which the securities were acquired and the anticipated commencement of the public offering; and

(c) the nature of the funding provided, including, but not limited to the issuer's need for funding before the public offering.

.03 Underwriting Compensation Securities Acquired Other than from the Issuer. Notwithstanding paragraph (j)(22), FINRA may exclude securities acquired from a third-party entity from underwriting compensation. To determine whether an acquisition of securities from a third-party entity may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the nature of the relationship between the issuer and the third party, if any;

(b) the nature of the transactions in which the securities were acquired, including, but not limited to, whether the transactions are engaged in as part of the participating member's ordinary course of business; and

(c) any disparity between the price paid and the offering price or market price.

.04 Underwriting Compensation Resulting from Issuer Directed Sales Programs. Notwithstanding paragraph (j)(15) and (22), FINRA may exclude from underwriting compensation securities acquired by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program. To determine whether an acquisition of securities by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the existence of a pre-existing relationship between the issuer and the person acquiring the securities;

(b) the nature of the relationship; and

(c) whether the securities were acquired on the same terms and at the same price as other similarly-situated persons participating in the directed sales program.

.05 Disclosure of Underwriting Compensation. A description of each item of underwriting compensation received or to be received by a participating member must be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document). The description shall include the dollar amount ascribed to each individual item of compensation. When securities are acquired by a participating member, material terms and arrangements of the acquisition must also be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document) when applicable, such as exercise terms, demand and piggyback registration rights and lock-up periods that may apply. Similarly, if underwriting compensation consists of a right of first refusal to participate in the distribution of a future public offering, private placement or other financing, the description should reference the existence of such right and its duration.

.06 Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

(a) Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation value. Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule.

(b) The term “derivative instrument” means any “eligible OTC derivative instrument” as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term “fair price” means the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm’s length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price.

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5120. Offerings of Members' Securities

5121. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraph (1) or (2).

(1) There must be prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering, and one of the following conditions must be met:

(A) the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(12)(E);

(B) the securities offered have a bona fide public market; or

(C) the securities offered are investment grade rated or are securities in the same series that have equal rights and obligations as investment grade rated securities.

(2) (A) A qualified independent underwriter has participated in the preparation of the registration statement and the prospectus, offering circular, or similar document and has exercised the usual standards of "due diligence" in respect thereto; and

(B) there must be prominent disclosure in the prospectus, offering circular or similar document for the offering of:

(i) the nature of the conflict of interest;

(ii) the name of the member acting as qualified independent underwriter; and

(iii) a brief statement regarding the role and responsibilities of the qualified independent underwriter.

(b) Escrow of Proceeds; Net Capital Computation

(1) All proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with subparagraph (2) hereof.

(2) Any member offering its securities pursuant to this Rule shall immediately notify FINRA when the public offering has been terminated and settlement effected and shall file with FINRA a computation of its net capital computed pursuant to the provisions of SEA Rule 15c3-1 (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the member calculates its net capital requirement using the alternative standard (set forth in Rule 15c3-1(a)(1)(ii)), its net capital is less than seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, all monies received from sales of securities of the public offering must be returned in full to the purchasers thereof and the offering

withdrawn, unless the member has obtained from the SEC a specific exemption from the net capital rule. Proceeds from the sales of securities in the public offering may be taken into consideration in computing net capital ratio for purposes of this paragraph.

(3) Any member offering its securities pursuant to this Rule shall disclose in the registration statement, offering circular or similar document a date by which the offering is reasonably expected to be completed and the terms upon which the proceeds will be released from the escrow account described in paragraph (b)(1).

(c) Discretionary Accounts

Notwithstanding Rule 3260, no member that has a conflict of interest may sell to a discretionary account any security with respect to which the conflict exists, unless the member has received specific written approval of the transaction from the account holder and retains documentation of the approval in its records.

(d) Application of Rule 5110

Any public offering subject to paragraph (a)(2) is subject to Rule 5110, whether or not the offering would be otherwise exempted from the filing or other requirements of that rule.

(e) Requests for Exemption from Rule 5121

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate.

(f) Definitions

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

(1) Affiliate

The term "affiliate" means an entity that controls, is controlled by or is under common control with a member.

(2) Beneficial Ownership

The term "beneficial ownership" means the right to the economic benefits of a security.

(3) Bona Fide Public Market

The term "bona fide public market" means a market for a security of an issuer that has been reporting under the Exchange Act for at least 90 days and is current in its reporting requirements, and whose securities are traded on a national securities exchange with an Average Daily Trading Volume (as provided by SEC Regulation M) of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million.

(4) Common Equity

The term "common equity" means the total number of shares of common stock outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(5) Conflict of Interest

The term "conflict of interest" means, if at the time of a member's participation in an entity's public offering, any of the following applies:

(A) the securities are to be issued by the member;

(B) the issuer controls, is controlled by or is under common control with the member or the member's associated persons;

(C) at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be:

(i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or

(ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate; or

(D) as a result of the public offering and any transactions contemplated at the time of the public offering:

(i) the member will be an affiliate of the issuer;

(ii) the member will become publicly owned; or

(iii) the issuer will become a member or form a broker-dealer subsidiary.

(6) Control

(A) The term "control" means:

(i) beneficial ownership of 10 percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member's participation in the public offering;

(ii) the right to 10 percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering;

(iii) beneficial ownership of 10 percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or

(iv) the power to direct or cause the direction of the management or policies of an entity.

(B) The term "common control" means the same natural person or entity controls two or more entities.

(7) Entity

For purposes of the definitions of affiliate, conflict of interest and control under this Rule, the term "entity":

(A) includes a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons; and

(B) excludes the following:

(i) an investment company registered under the Investment Company Act;

(ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act;

(iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code; or

(iv) a "direct participation program" as defined in Rule 2310.

(8) Investment Grade Rated

The term "investment grade rated" refers to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

(9) Net Offering Proceeds

The term “net offering proceeds” means offering proceeds less all expenses of issuance and distribution.

(10) Preferred Equity

The term "preferred equity" means the aggregate capital invested by all persons in the preferred securities outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(11) Prominent Disclosure

A member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B) by:

(A) providing the notation "(Conflicts of Interest)" following the listing of the Plan of Distribution in the Table of Contents section required in Item 502 of SEC Regulation S-K, and by providing such disclosures in the Plan of Distribution section required in Item 508 of SEC Regulation S-K and any Prospectus Summary section required in Item 503 of SEC Regulation S-K; or

(B) for an offering document not subject to SEC Regulation S-K, by providing disclosure on the front page of the offering document that a conflict exists, with a cross-reference to the discussion within the offering document and in the summary of the offering document if one is included.

(12) Qualified Independent Underwriter

The term "qualified independent underwriter" means a member:

(A) that does not have a conflict of interest and is not an affiliate of any member that has a conflict of interest;

(B) that does not beneficially own as of the date of the member's participation in the public offering, more than 5% of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days;

(C) that has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act, specifically including those inherent in Section 11 thereof; and

(D) that has served as underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering without a registration statement. This requirement will be deemed satisfied if, during the past three years, the member:

(i) with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering; and

(ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering.

(E) none of whose associated persons who function in a supervisory capacity who is responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) has been convicted within ten years prior to the filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;

(ii) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or

(iii) has been suspended or barred from association with any member by an order or decision of the SEC, any state, FINRA or any other self-regulatory organization within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.

(13) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act; notification on Form 1A filed with the SEC pursuant to the provisions of Securities Act Rule 252; or any other document, by whatever name known, initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any federal or state agency.

(14) Subordinated Debt

The term "subordinated debt" includes (A) debt of an issuer which is expressly subordinate in right of payment to, or with a claim on assets subordinate to, any existing or future debt of such issuer; or (B) all debt that is specified as subordinated at the time of issuance. Subordinated debt shall not include short-term debt with maturity at issuance of less than one year and secured debt and bank debt not specified as subordinated debt at the time of issuance.

5122. Private Placements of Securities Issued by Members

(a) Definitions

(1) Member Private Offering

A "member private offering" means a private placement of unregistered securities issued by a member or a control entity.

(2) Control Entity

A "control entity" means any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons.

(3) Control

The term "control" means 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. Control will be determined immediately after the closing of an offering, and in the case of an offering with multiple intended closings, immediately following each closing.

(4) Private Placement

The term "private placement" means a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act.

(b) Requirements

No member or associated person may offer or sell any security in a Member Private Offering unless the following conditions have been met:

(1) Disclosure Requirements

(A) If an 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 disclosures addressing:

(i) intended use of the offering proceeds; and

(ii) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons.

(B) If an offering does not have a private placement memorandum or term sheet, then the member must prepare an offering document that contains the disclosures required in paragraph (b)(1)(A)(i) and (ii) and provide such document to each prospective investor.

(2) Filing Requirements

A member must file the private placement memorandum, term sheet or such other offering document 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.

(3) Use of Offering Proceeds

For each Member Private Offering, at least 85% of the offering proceeds raised must be used for business purposes, which shall not include offering costs, discounts, commissions or any other cash or non-cash sales incentives. The use of the offering proceeds also must be consistent with the disclosures required in paragraph (b)(1).

If, in connection with the offer and sale of any security in a Member Private Offering, a member or associated person discovers after the fact that one or more of the conditions listed above have not been met, the member or associated person must promptly conform the offering to comply with this Rule.

(c) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) offerings sold solely to:

(A) institutional accounts, as defined in Rule 4512(c);

(B) qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;

(C) qualified institutional buyers, as defined in Securities Act Rule 144A;

(D) investment companies, as defined in Section 3 of the Investment Company Act;

(E) an entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A; and

(F) banks, as defined in Section 3(a)(2) of the Securities Act.

(2) offerings of exempted securities, as defined in Section 3(a)12 of the Exchange Act;

(3) offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;

(4) 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);

(5) offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act;

(6) offerings of subordinated loans under SEA Rule 15c3-1, Appendix D (see NASD Notice to Members 02-32 (June 2002));

(7) offerings of "variable contracts", as defined in Rule 2320(b);

(8) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(h)(2)(D);

(9) offerings of unregistered investment grade rated debt and preferred securities;

(10) offerings to employees and affiliates of the issuer or its control entities;

(11) 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 investments on the part of the investor;

(12) offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(5) of the Commodity Exchange Act;

(13) offerings of equity and credit derivatives, including OTC options; provided that the derivative is not based principally on the member or any if its control entities; and

(14) offerings filed with the Department under Rules 2310, 5110 or Rule 5121.

(d) Confidential Treatment

FINRA shall accord confidential treatment to all documents and information filed pursuant to this Rule and shall utilize such documents and information solely for the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

(e) Application for Exemption

Pursuant to the Rule 9600 Series, FINRA may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

• • • Supplementary Material: --------------

.01 Private Placement Memorandum. Nothing in this rule shall require a member to prepare a private placement memorandum. A member may satisfy the disclosure and filing requirements in the Rule with an offering

5123. Private Placements of Securities

(a) Filing Requirements

Each member that sells a security in a non-public offering in reliance on an available exemption from registration under the Securities Act ("private placement") must: (i) submit to FINRA, or have submitted on its behalf by a designated member, a copy of any private placement memorandum, term sheet or other offering document, including any materially amended versions thereof, used in connection with such sale within 15 calendar days of the date of first sale; or (ii) notify FINRA that no such offering documents were used. Members must provide FINRA with the required documents or notification and related information, if known, by filing an electronic form in the manner prescribed by FINRA.

(b) Exemptions

The following private placements are exempt from the requirements of this Rule:

(1) offerings sold by the member or person associated with the member solely to any one or more of the following:

(A) institutional accounts, as defined in Rule 4512(c);

(B) qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;

(C) qualified institutional buyers, as defined in Securities Act Rule 144A;

(D) investment companies, as defined in Section 3 of the Investment Company Act;

(E) an entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A;

(F) banks, as defined in Section 3(a)(2) of the Securities Act;

(G) employees and affiliates, as defined in Rule 5121, of the issuer;

(H) knowledgeable employees as defined in Investment Company Act Rule 3c-5;

(I) eligible contract participants, as defined in Section 3(a)(65) of the Exchange Act; and

(J) accredited investors described in Securities Act Rule 501(a)(1), (2), (3) or (7).

(2) offerings of exempted securities, as defined in Section 3(a)(12) of the Exchange Act;

(3) offerings made pursuant to Securities Act Rule 144A or SEC Regulation S;

(4) offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act and debt securities sold by members pursuant to

Section 4(2) of the Securities Act so long as the maturity does not exceed 397 days and the securities are issued in minimum denominations of $150,000 (or the equivalent thereof in another currency);

(5) offerings of subordinated loans under SEA Rule 15c3-1, Appendix D (see NASD Notice to Members 02-32 (June 2002));

(6) offerings of "variable contracts," as defined in Rule 2320(b)(2);

(7) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(h)(2)(D);

(8) offerings of non-convertible debt or preferred securities that meet the transaction eligibility criteria for registering primary offerings of non-convertible securities on Forms S-3 and F-3;

(9) 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 investments on the part of the investor;

(10) offerings of securities of a commodity pool operated by a commodity pool operator, as defined under Section 1a(11) of the Commodity Exchange Act;

(11) business combination transactions as defined in Securities Act Rule 165(f);

(12) offerings of registered investment companies;

(13) standardized options, as defined in Securities Act Rule 238; and

(14) offerings filed with FINRA under Rules 2310, 5110, 5121 and 5122, or exempt from filing thereunder in accordance with Rule 5110(h)(1).

(c) Confidential Treatment

FINRA shall accord confidential treatment to all documents and information filed pursuant to this Rule and shall utilize such documents and information solely for the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other regulatory purposes deemed appropriate by FINRA.

(d) Application for Exemption

Pursuant to the Rule 9600 Series, FINRA may exempt a member or associated person from the provisions of this Rule for good cause shown.

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9200. DISCIPLINARY PROCEEDINGS

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9217. Violations Appropriate for Disposition Under Plan Pursuant to SEA Rule 19d-1(c)(2)

Any member of FINRA that is also a member of the New York Stock Exchange LLC ("NYSE") ("Dual Member") (including any persons affiliated with such member) may be subject to a fine under Rule 9216(b) with respect to any rule or By-Law provision listed in this Rule that applies to such member or person. However, any Dual Member that was not also a member of NASD as of July 30, 2007 and that does not engage in any activities that otherwise would require it to be a FINRA member (and its affiliated persons that are not otherwise subject to NASD rules) shall only be subject to a fine under Rule 9216(b) with respect to the following rules or By-Law provisions listed in this Rule: any FINRA By-Law or Schedule to the By-Laws, FINRA rule, SEA rule, or NYSE rule.

Any member of FINRA that is not also a member of the NYSE (and its associated persons that are not otherwise subject to NYSE rules) may be subject to a fine under Rule

9216(b) with respect to any rule or By-Laws provision listed in this Rule, with the exception of the NYSE rules.

- Article IV of the FINRA By-Laws — Failure to timely submit amendments to Form BD.
- Article V of the FINRA By-Laws — Failure to timely submit amendments to Form U4.
- Article V of the FINRA By-Laws — Failure to timely submit amendments to Form U5.
- Schedule A. Sec. 1(b) of the FINRA By-Laws — Failure to make accurate payment of Trading Activity Fee.
- Rule 1210.04 — Failure to timely register.
- Rule 1240 — Failure to comply with the continuing education requirements.
- Rules 2210, 2211, 2212, 2213, 2215, and 2216 — Communications with the public.
- Rule 2220 — Options Communications.
- Rule 2251(a) — Failure to timely forward proxy and other issuer-related materials.
- Rule 2266 — Failure to provide written notification of availability of SIPC information at account opening or annually thereafter.
- Rule 2360(b)(3) and (b)(4) — Failure to comply with options position and exercise limits.
- Rule 2360(b)(5) — Failure to report options positions.

- Rule 2360(b)(23) — Failure to comply with contrary exercise advice procedures.

- Rule 3110 — Failure to maintain adequate written supervisory procedures where the underlying conduct is subject to Rule 9217.

- Rule 3160(a)(1), (3), (4) and (5) — Standards of conduct for conducting broker-dealer services on or off the premises of a financial institution pursuant to a networking arrangement, but excluding the networking agreement requirements.

- Rule 3170 — Failure to timely file reports pursuant to the Taping Rule.

- Rule 3210 — Failure to obtain consent of employer member, or give notification to executing member.

- Rule 4311(b) — Failure to obtain approval of carrying agreement.

- Rule 4360(b) — Failure to maintain adequate fidelity bond coverage.

- Rule 4370(a), (b), (c), (e) and (f) — Requirements to create, maintain and update a written business continuity plan and disclosure of such to customers.

- Rule 4510 Series — Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with FINRA rules.

- Rule 4517 — Failure to report, review or update executive representative designation and contact information.

- Rule 4521(d) — Failure to submit reports of cash and margin account balances.

- Rule 4524 — Failure to timely file or filing of incomplete reports or information.

- Rule 4530 — Failure to timely file reports.

- Rule 4560 — Failure to timely file reports of short positions on Form NS-1.
- Rule 4590 — Failure to synchronize business clocks used for recording date and time as required by applicable FINRA By-laws and rules.
- Rule 5110(a) — Failure to timely file or filing of incomplete documents or information.
- Rule 5121(a) — Failure to prominently disclose conflict of interest.
- Rule 5121(b)(2) — Failure to give timely notification of termination or settlement of public offering, or failure to file net capital computation.
- Rule 5122(b)(2) — Failure to timely file private placement documents.
- Rule 5190 — Failure to give timely notification of participation in offerings.
- Rules 6282, 6380A, 6380B, 6550, 6622, 6730, 7130, 7160, 7230A, 7230B, 7260A, 7260B, 7330, and 7360 — Transaction reporting in equity and debt securities.
- Rules 6181 and 6623 — Failure to timely report transactions in NMS, OTC and restricted equity securities.
- Rules 6182 and 6624 — Failure to accurately mark short sale transactions in NMS and OTC equity securities.
- Rule 6250 — Failure to comply with quote and order access requirements for FINRA's Alternative Display Facility.
- Rule 6760 — Failure to give timely or complete notification concerning offerings of TRACE-Eligible Securities.
- Rules 7440 and 7450 — Failure to submit data in accordance with the Order Audit Trail System ("OATS").
- Rules 8211 and 8213 — Failure to submit trading data as requested.

- Rule 11870 — Failure to abide by Customer Account Transfer Contracts.
- Failure to provide or update contact information as required by FINRA rules.
- Rule 311T(b)(5) — Failure of a member organization to have individuals responsible and qualified for the positions of Financial Principal, Operations Principal, Compliance Official, Branch Office Manager and Supervisory Analyst.
- Rules 312T(a), (b) and (c), 313T— Reporting rule violations.
- Rule 312T(i) — Failure to obtain approval rule violations.
- Rule 408T(a) — Requirement that written authorization be obtained for discretionary power in a customer's account.
- Rule 416AT — Failure to promptly provide or promptly update required membership profile information through the Electronic Filing Platform ("EFP"), or failure to electronically certify that required membership profile information is complete and accurate.
- SEA Rules 17a-3(a) and 17a-4 — Record retention rule violations.
- SEA Rule 10b-10 — Confirmation of Transactions.
- SEA Rule 17a-5 — Failure to timely file FOCUS reports and annual audit reports.
- SEA Rule 17a-10 — Failure to timely file Schedule I.
- Rule 200(g) of SEC Regulation SHO — Failure to accurately mark sell orders of equity securities.
- Rule 602(b)(5) of SEC Regulation NMS — Failure to properly update published quotations in certain Electronic Communication Networks ("ECNs").
- Rule 604 of SEC Regulation NMS — Failure to properly display limit orders.

• Rule 605(a)(1) and (3) of SEC Regulation NMS — Failure to timely report or provide complete order execution information.

• Rule 606 of SEC Regulation NMS — Failure to timely disclose or provide complete order routing information.

• MSRB Rule A-12(c) and (f) — Failure to timely pay annual fee and failure to designate and update electronic mail contact information for communications with MSRB.

• MSRB Rules G-2 and G-3 (b)(ii)(D) and (c)(ii)(D) — Failure to timely register.

• MSRB Rule G-3(i) — Failure to comply with the continuing education requirements.

• MSRB Rule G-6 — Failure to maintain adequate fidelity bond coverage.

• MSRB Rules G-8 and G-9 — Record retention rule violations.

• MSRB Rule G-10(a) — Failure to deliver investor brochure to customers promptly.

• MSRB Rule G-12 — Failure to abide by uniform practice rules.

• MSRB Rule G-14 — Failure to submit reports.

• MSRB Rule G-21 — Advertising.

• MSRB Rule G-27(c) — Failure to maintain adequate written supervisory procedures where the underlying conduct is subject to Rule 9217.

• MSRB Rule G-32 — Failure to timely submit reports.

• MSRB Rule G-37 — Failure to timely submit reports for political contributions.

* * * * *

EXHIBIT 5

Below is the text of the proposed rule change.

NOTE: The proposed rule change amends and reorganizes the rule. Where entire paragraphs of the rule are being moved, paragraphs that are moved to a new location in the rule are not marked if there are no changes to the text of the paragraph. If, however, there are changes to the text of a paragraph that is being relocated, the proposed new language in the paragraph is underlined and proposed deletions are bracketed.

* * * * *

2300. SPECIAL PRODUCTS

2310. Direct Participation Programs

(a) No Change.

(b) Requirements

(1) through (3) No Change.

(4) Organization and Offering Expenses

(A) through (B) No Change.

(C) The organization and offering expenses subject to the limitations in paragraph (b)(4)(B)(i) above include the following:

(i) No Change.

(ii) underwriting compensation[, which includes but is not limited to items of compensation listed in Rule 5110(c)(3)] <u>as defined in Rule 5110(j)(22)</u> including payments:

a. to any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities;

b. to any registered representative of a member who receives transaction-based compensation in connection with the offering, except to the extent that such compensation has been included in a. above;

c. to any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program or REIT securities, except:

1. to the extent that such compensation has been included in a. above;

2. for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and

3. for a registered representative whose sales activities are *de minimis* and incidental to his or her clerical or ministerial job functions; or

d. for training and education meetings, legal services provided to a member in connection with the offering, advertising and sales material generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

(iii) No Change.

(D) through (G) No Change.

(5) through (6) No Change.

(c) through (d) No Change.

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5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

[(b)](a) [Filing] Requirements for Public Offerings

(1) General

[(f)(1)](A) No member or person associated with a member shall participate [in any manner] in a public offering [of securities after any arrangement proposed in connection with the public offering, or the] in which the terms and conditions relating thereto, including the aggregate amount of underwriting compensation, [has been determined to be] are unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any rule or regulation of FINRA.

(B) Any member acting as a managing underwriter or in a similar capacity must notify the other members participating in the public offering if informed of an opinion by FINRA that the underwriting terms and arrangements are unfair and unreasonable and the proposed terms and arrangements have not been appropriately modified.

(C) No member [or person associated with a member shall participate in any manner] may engage in the distribution or sale of securities in any public offering [of securities subject to] required to be filed by this Rule, Rule 2310 or Rule 5121 unless:

(i) documents and information [as] specified [herein relating to the offering] in paragraph (a)(4) have been filed with [and reviewed by] FINRA[.]; and

(ii) FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements.

[(2) Means of Filing]

[Documents or information required by this Rule to be filed with FINRA shall be considered to be filed only upon receipt by its Corporate Financing Department.]

[(9)](2) Offerings Required to be Filed

All public offerings in which a member participates must be filed with FINRA for review, except as exempted from the filing requirement under paragraph (h).

[Documents and information relating to all other public offerings including, but not limited to, the following must be filed with FINRA for review:]

[(A) direct participation programs as defined in Rule 2310(a);]

[(B) mortgage and real estate investment trusts;]

[(C) rights offerings;]

[(D) securities exempt from registration with the SEC pursuant to Section 3(a)(11) of the Securities Act;]

[(E) securities exempt from registration with the SEC pursuant to Rule 504 of SEC Regulation D, unless the securities are "restricted securities" under Securities Act Rule 144(a)(3);]

[(F) securities offered by a bank, savings and loan association, or common carrier even though such offering may be exempt from registration with the SEC;]

[(G) securities offered pursuant to SEC Regulation A;]

[(H) exchange offers that are exempt from registration with the SEC under Sections 3(a)(4), 3(a)(9), or 3(a)(11) of the Securities Act (if a member's participation involves active solicitation activities) or registered with the SEC (if a member is acting as dealer-manager) (collectively "exchange offers"), except for exchange offers exempt from filing pursuant to subparagraph (7)(F) above that are not subject to filing by subparagraph (9)(I) below;]

[(I) any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; and]

[(J) any offerings of a similar nature that are not exempt under subparagraph (7) or (8) above.]

[(4)]<u>(3)</u> [Requirement for Filing]<u>Timely Filing Requirements</u>

(A) [Unless filed by the issuer, the managing underwriter, or another member, a] <u>A</u> member that [anticipates participating] <u>participates</u> in a public offering [of securities subject to this Rule shall] <u>that is required to be filed under paragraph (a)(2) must</u> file [with FINRA] the documents and information [with respect to the offering] specified in [sub]paragraph[s] <u>(a)</u>(<u>4</u>[5]) [and (6) below]:

(i) no later than [one] three business days after any [of such] documents are filed with or submitted to:

a. the SEC, including confidential filings or submissions; or

b. any state securities commission or other similar U.S. regulatory authority; or

(ii) if not filed with or submitted to any such regulatory authority, at least [fifteen]15 business days prior to the [anticipated date on which offers will commence] commencement of sales.

(B) A member that participates in a public offering is not required to make a filing if the filing has been made by a member that is responsible for managing the offering or by another member that is in the syndicate or selling group.

[No sales of securities subject to this Rule shall commence unless:]

[(i) the documents and information specified in subparagraphs (5) and (6) below have been filed with and reviewed by FINRA; and]

[(ii) FINRA has provided an opinion that it has no objections to the proposed underwriting and other terms and arrangements or an opinion that the proposed underwriting and other terms and arrangements are unfair and unreasonable. If FINRA's opinion states that the proposed underwriting and other terms and arrangements are unfair and unreasonable, the member may file modifications to the proposed underwriting and other terms and arrangements for further review.]

[(C) Any member acting as a managing underwriter or in a similar capacity that has been informed of an opinion by FINRA, or a determination by the appropriate standing committee of the Board of Governors, that the proposed underwriting terms and arrangements of a proposed offering are unfair or unreasonable, and the proposed terms and arrangements have not been modified to conform to the standards of fairness and reasonableness, shall notify all other members proposing to participate in the offering of that opinion or determination at a time sufficiently prior to the effective date of the offering or the commencement of sales so the other members will have an opportunity as a result of specific notice to comply with their obligation not to participate in any way in the distribution of a public offering containing arrangements, terms and conditions that are unfair or unreasonable.]

[(5)](4) Documents and Information Required to be Filed

(A) The following documents [relating to all proposed public offerings of securities that are] required to be filed under paragraph [(b)(4)](a) [above shall] must be filed [through] in FINRA's Public Offering [electronic filing s]System for review by providing the SEC document identification number if available:

(i) [T]the registration statement, offering circular, offering memorandum, notification of filing, notice of intention, application for conversion, and[/or] any other document used to offer securities to the public;

(ii) all documents relevant to the underwriting terms and arrangements, including [A]any proposed underwriting agreement, agreement among underwriters, selected dealer's agreement, agency agreement, purchase agreement, letter of intent, engagement letter, consulting agreement, partnership agreement, underwriter's warrant agreement, or escrow agreement, provided that industry-standard master forms of agreement need not be filed unless otherwise specifically requested by FINRA [and any other document that describes the underwriting or other arrangements in connection with or related to the distribution, and the terms and conditions relating thereto; and any other information or documents that may be material to or part of the said arrangements, terms and conditions and that may have a bearing on FINRA's review];

(iii) [Each pre- and post-effective amendment to the registration statement or other offering document, with a copy marked to show changes; and any other amended document previously filed pursuant to subparagraphs (i) and (ii) above, with a copy marked to show changes; and] if amendments to any documents previously filed contain changes that impact the underwriting terms and arrangements for the public offering, marked pages showing the changes to such document;

(iv) the final registration statement declared effective by the SEC, or the equivalent final offering document, the notice of effectiveness issued by the SEC or any other U.S. regulatory authority, the executed form of the final distribution-related documents and any other document submitted to FINRA for review, each if applicable; and [The final registration statement declared effective by the SEC or equivalent final offering document and a list of the members of the underwriting syndicate, if not indicated therein, and one copy of the executed form of the final underwriting documents and any other document submitted to FINRA for review.]

(v[B]) all requests for withdrawal filed with or submitted to the SEC or any other U.S. regulatory authority, including any correspondence submitted to the SEC for the withdrawal of confidential filings or submissions.

[Documents that are filed with the SEC through the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") System that are referenced in FINRA's electronic filing system shall be treated as filed with FINRA.]

[(6) Information Required to be Filed]

(B[A]) Any [person] member filing documents with FINRA pursuant to [sub]paragraph (a)(4)(A) [above shall] must file [provide] the following information with respect to the offering [through] in FINRA's Public Offering [electronic filing s]System:

(i) an estimate of the maximum public offering price;

(ii) an estimate of the maximum value for each item of underwriting compensation [an estimate of the maximum underwriting discount or commission; maximum reimbursement of underwriter's expenses, and underwriter's counsel's fees (except for reimbursement of "blue sky" fees); maximum financial consulting and/or advisory fees to the underwriter and related persons; maximum finder's fees; and a statement of any other type and amount of compensation which may accrue to the underwriter and related persons];

(iii) a representation as to whether any officer or director of the issuer and any beneficial owner of 5% or more of any class of the issuer's equity and equity-linked securities is an associated person or affiliate of a participating member;

[(iii) a statement of the association or affiliation with any participating member of any officer or director of the issuer, of any beneficial owner of 5% or more of any class of the issuer's securities, and of any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering, except for purchases described in paragraph (c)(3)(B)(iv) below. This statement must identify:]

[a. the person;]

[b. the member; and]

[c. the number of equity securities or the face value of debt securities owned by such person, the date such securities were acquired, and the price paid for such securities.]

[(iv) a detailed explanation of any other arrangement entered into during the 180-day period immediately preceding the required filing date of the public offering, which arrangement provides for the receipt of any item of value or the transfer of any warrants, options, or other securities from the issuer to the underwriter and related persons, provided however:]

[a. information regarding debt securities and derivative instruments not considered an item of value under paragraphs (c)(3)(B)(vi) and (vii) is not required to be filed; and]

[b. information initially filed in connection with debt securities and derivative instruments acquired or entered into for "fair price" as defined in paragraph (a)(9), but not excluded from items of value under paragraph (c)(3)(B)(vi) or (vii), may be limited to a brief description of the transaction (additional information may be required in the review process) and a representation by the member that a registered principal or senior manager on behalf of the member has determined that the transaction was or (if the pricing terms have not been set) will be entered into at a fair price as defined in paragraph (a)(9).]

(iv) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:

a. non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering must be filed and also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price; and

b. non-convertible or non-exchangeable debt securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering.

[(v) a statement demonstrating compliance with all of the criteria of an exception from underwriting compensation in paragraph (d)(5) below, when applicable; and]

(v) if applicable, a representation of compliance with all of the criteria for any exception from underwriting compensation provided in paragraph (d); and

(vi) a detailed explanation and all [any] documents related to[:]

[a.] the modification of any information or representation previously provided to FINRA during the review period, whether or not FINRA has issued a no objections opinion. [or of any item of underwriting compensation including the information required in paragraph (b)(6)(A)(iii) above with respect to any securities of the issuer acquired subsequent to the required filing date and prior to the effectiveness or commencement of the offering; or]

[b. any new arrangement that provides for the receipt of any additional item of value by any participating member subsequent to the issuance of an opinion of no objections to the underwriting terms and arrangements by FINRA and within 90 days immediately following the date of effectiveness or commencement of sales of the public offering, provided, however, that information filed in connection with debt securities and derivative instruments acquired or entered into for a "fair price" as defined in paragraph (a)(9) may be limited as described in paragraph (b)(6)(A)(iv)b.]

[(vii) any other information required to be filed under this Rule.]

(C[B]) [Any person filing documents pursuant to paragraph (b)(5) above shall notify FINRA through its electronic filing system that the offering has been declared effective or approved by the SEC or other agency no later than one business day following such declaration or approval or that the offering has been withdrawn or abandoned within three business days following the withdrawal or decision to abandon the offering.]

In the event an offering filed pursuant to this Rule is not completed according to the terms of an agreement entered into by the issuer and a participating member, any member receiving underwriting compensation must provide written notification to FINRA of all underwriting compensation received or to be received pursuant to paragraph (g)(5), including a copy of any agreement governing the arrangement.

[(b)(3)](D) [Confidential Treatment]

FINRA [shall accord] will provide confidential treatment to all documents and information filed pursuant to this Rule and [shall utilize] use such documents and information solely for [the purpose of review to determine compliance with the provisions of applicable FINRA rules or for other] regulatory purposes [deemed appropriate by FINRA].

(E) Notwithstanding paragraph (a)(4)(A) and (B), with respect to a shelf offering, the following documents and information must be filed in FINRA's Public Offering System for review:

(i) the registration statement number; and

(ii) if requested by FINRA, other documents and information set forth in paragraph (a)(4)(A) and (B).

[(c)](b) Disclosure Requirements for Underwriting Compensation [and Arrangements]

[(1) General]

[No member or person associated with a member shall participate in any manner in any public offering of securities in which the underwriting or other terms or arrangements in connection with or relating to the distribution of the securities, or the terms and conditions related thereto, are unfair or unreasonable.]

[(2) Amount of Underwriting Compensation]

[(A) No member or person associated with a member shall receive an amount of underwriting compensation in connection with a public offering that is unfair or unreasonable and no member or person associated with a member shall underwrite or participate in a public offering of securities if the underwriting compensation in connection with the public offering is unfair or unreasonable.]

[(B) For purposes of determining the amount of underwriting compensation, all items of value received or to be received from any source by the underwriter and related persons which are deemed to be in connection with or related to the distribution of the public offering as determined pursuant to subparagraph (3) below shall be included.]

([C]1) [All items of] A description of each item of underwriting compensation received or to be received by a participating member must [shall] be disclosed in the section on [underwriting or] distribution arrangements in the prospectus or similar document.

(2) [and, if the underwriting compensation includes items of compensation in addition to the] Any underwriting compensation consisting of a commission or discount to the public offering price must be disclosed on the cover page of the prospectus or similar document[,]. If the underwriting compensation includes items of compensation in addition to the commission or discount disclosed on the cover page of the prospectus or similar document, a footnote to the offering proceeds table on the cover page of the prospectus or similar document shall include a cross-reference to the section on [underwriting or] distribution arrangements.

[(D) For purposes of determining the currently effective guideline on the maximum amount of underwriting compensation considered fair and reasonable, the following factors, as well as any other relevant factors and circumstances, shall be taken into consideration:]

[(i) the offering proceeds;]

[(ii) the amount of risk assumed by the underwriter and related persons, which is determined by:]

[a. whether the offering is being underwritten on a "firm commitment" or "best efforts" basis and]

[b. whether the offering is an initial or secondary offering; and]

[(iii) the type of securities being offered.]

[(E) The maximum amount of compensation (stated as a percentage of the dollar amount of the offering proceeds) that is considered fair and reasonable generally will vary directly with the amount of risk to be assumed by participating members and inversely with the dollar amount of the offering proceeds.]

[(3) Items of Value]

[(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to paragraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the public offering, as determined pursuant to paragraph (d) below shall be included:]

[(i) discount or commission;]

[(ii) reimbursement of expenses to or on behalf of the underwriter and related persons;]

[(iii) fees and expenses of underwriter's counsel (except for reimbursement of "blue sky" fees);]

[(iv) finder's fees, whether in the form of cash, securities or any other item of value;]

[(v) wholesaler's fees;]

[(vi) financial consulting and advisory fees, whether in the form of cash, securities, or any other item of value;]

[(vii) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, received;]

[a. for acting as private placement agent for the issuer;]

[b. for providing or arranging a loan, credit facility, merger or acquisition services, or any other service for the issuer;]

[c. as an investment in a private placement made by the issuer; or]

[d. at the time of the public offering;]

[(viii) special sales incentive items;]

[(ix) any right of first refusal provided to any participating member underwrite or participate in future public offerings, private placements or other financings, which will have a compensation value of 1% of the offering proceeds or that dollar amount contractually agreed to by the issuer and underwriter to waive the right of first refusal;]

[(x) compensation to be received by the underwriter and related persons or by any person nominated by the underwriter as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;]

[(xi) commissions, expense reimbursements, previously or other compensation to be received by the underwriter and related persons as a result of the exercise or conversion within twelve months following the effective date of the offering of warrants, options, convertible securities, or similar securities distributed as part of the public offering;]

[(xii) fees of a qualified independent underwriter; and]

[(xiii) compensation, including expense reimbursements, paid to any member in connection with a proposed public offering that was not completed, unless the member does not participate in the revised public offering.]

[(B) Notwithstanding paragraph (c)(3)(A) above, the following shall not be considered an item of value:]

[(i) expenses customarily borne by an issuer, such as printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; and accountant's fees, whether or not paid through a participating member;]

[(ii) cash compensation for acting as placement agent for a private placement or for providing a loan, credit facility, or for services in connection with a merger/acquisition;]

[(iii) listed securities purchased in public market transactions;]

[(iv) securities acquired through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code;]

[(v) securities acquired by an investment company registered under the Investment Company Act;]

[(vi) nonconvertible or non-exchangeable debt securities acquired for a fair price in the ordinary course of business in a transaction unrelated to the public offering; and]

[(vii) derivative instruments entered into for a fair price in the ordinary course of business in a transaction unrelated to the public offering.]

[(e)]<u>(c)</u> Valuation of [Non-Cash]<u>Underwriting</u> Compensation

[For purposes of determining the value to be assigned to securities received as underwriting compensation, the following criteria and procedures shall be applied.]

(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security

A[n underwriter and related person] participating member may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:

(A) the security received or the security underlying the warrant or convertible security received is identical to the security offered to the public or to a security with a bona fide [independent]public market; or

(B) the security can be accurately valued, as required by paragraph (g)(1) of this Rule[(f)(2)(I) below].

(2) Valuation of Non-Convertible Securities [That Do Not Have an Exercise or Conversion Price]

Non-convertible [S]securities received as underwriting compensation [that do not have an exercise or conversion price shall]will have a compensation value based on:

(A) the difference between:

(i) either the market price per security on the date of acquisition, or, if no bona fide [independent]public market exists for the security, the public offering price per security; and

(ii) the per security cost;

(B) multiplied by the number of securities received or to be received as underwriting compensation;

(C) divided by the offering proceeds; and

(D) multiplied by one hundred.

(3) Valuation of Convertible Securities [That Have an Exercise or Conversion Price]

Options, warrants or convertible securities [that have an exercise or conversion price] ("warrants") shall have a compensation value based on the following formula:

(A) the public offering price per security multiplied by .65;

(B) minus the resultant of the exercise or conversion price per warrant less either:

(i) the market price per security on the date of acquisition, where a bona fide [independent]public market exists for the security; or

(ii) the public offering price per security;

(C) divided by two;

(D) multiplied by the number of securities underlying the warrants;

(E) less the total price paid for the warrants;

(F) divided by the offering proceeds; and

(G) multiplied by one hundred;

(H) provided, however, that, notwithstanding paragraph [(e)](c)(4) of this Rule[below], such warrants shall have a compensation value of at least .2% of the offering proceeds for each amount of securities that is up to 1% of the securities being offered to the public (excluding securities subject to an overallotment option).

(4) Reduction in Valuation

If a participating member wishes to reduce the proposed maximum value of any securities received as underwriting compensation, it may do so by voluntarily agreeing to lock-up such securities for successive 180-day periods (in addition to the initial lock-up period required by paragraph (e) of this Rule if applicable). Each additional 180-day period will reduce the proposed maximum value attributable to such securities by 10%.

[Valuation Discount For Securities With a Longer Resale Restriction]

[A lower value equal to 10% of the calculated value shall be deducted for each 180-day period that the securities or underlying securities are restricted from sale or other disposition beyond the 180-day period of the lock-up restriction required by paragraph (g)(1) below. The transfers permitted during the lock-up restriction by paragraphs (g)(2)(A)(iii) through (iv) are not available for such securities.]

(5) Valuation of [Items of Value]Securities Acquired in Connection with a Fair Price Non-Convertible or Non-Exchangeable Debt or Derivative Instrument [or Debt Transaction]

Any non-convertible or non-exchangeable debt or derivative instrument[transaction] acquired or entered into at a "fair price" as defined in [paragraph (a)(9) and item of value] Supplementary Material .06(b) and underwriting compensation received in or receivable in the settlement, exercise or other terms of such non-convertible non-exchangeable debt or derivative [transaction]instrument shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the non-convertible or non-exchangeable debt or derivative [security]instrument is not a fair price, compensation will be calculated pursuant to this paragraph [(e)](c) or based on the difference between the fair price and the actual price.

(d) [Determination of Whether Items of Value Are Included In Underwriting Compensation] Securities Acquisitions Not Considered Underwriting Compensation

[(1) Pre-Offering Compensation]

[All items of value received and all arrangements entered into for the future receipt of an item of value by the underwriter and related persons during the period commencing 180 days immediately preceding the required filing date of the registration statement or similar document pursuant to paragraph (b)(4) above until the date of effectiveness or commencement of sales of the public offering will be considered to be underwriting compensation in connection with the public offering.]

[(2) Undisclosed and Post-Offering Compensation]

[All items of value received and all arrangements entered into for the future receipt of an item of value by any participating member that are not disclosed to FINRA prior to the date of effectiveness or commencement of sales of a public offering, including items of value received subsequent to the public offering, are subject to post-offering review to determine whether such items of value are, in fact, underwriting compensation for the public offering.]

[(3) Date of Receipt of Securities]

[Securities of the issuer acquired by the underwriter and related persons will be considered to be received for purposes of paragraphs (d)(1) and (d)(5) as of the date of the:]

[(A) closing of a private placement, if the securities were purchased in or received for arranging a private placement; or]

[(B) execution of a written contract with detailed provisions for the receipt of securities as compensation for a loan, credit facility, or put option; or]

[(C) transfer of beneficial ownership of the securities, if the securities were received as compensation for consulting or advisory services, merger or acquisition services, acting as a finder, or for any other service.]

[(4) Definitions]

[For purposes of paragraph (d)(5) below, the following terms will have the meanings stated below.]

[(A) An entity:]

[(i) includes a group of legal persons that either:]

[a. are contractually obligated to make co-investments and have previously made at least one such investment; or]

[b. have filed a Schedule 13D or 13G with the SEC that identifies the legal persons as members of a group that have agreed to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer in connection with a previous investment; and]

[(ii) may make its investment or loan through a wholly owned subsidiary (except when the entity is a group of legal persons).]

[(D) A right of pre-emption means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to:]

[(i) any option, shareholder agreement, or other contractual right entered into at the time of a purchase of securities;]

[(ii) the terms of the security purchased;]

[(iii) the issuer's charter or by-laws; or]

[(iv) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.]

[(5) Exceptions From Underwriting Compensation]

[Notwithstanding paragraph (d)(1) above, the following items of value] Securities acquired in transactions that meet the requirements of this paragraph (d) are excluded from underwriting compensation and not subject to the lock-up requirements of paragraph (e)(1), provided that the member does not condition its participation in the public offering on an acquisition of securities [under an exception] in a transaction that meets the requirements of this paragraph and any securities [purchased]acquired are [purchased]acquired at the same price and with the same terms as the securities purchased by all other investors.

([A]1) Purchases and Loans by Certain Affiliates [Entities]— Securities of the issuer purchased in a private placement or received as compensation [for] in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph [(b)(4)](a) [above] by [certain entities] a participating member's affiliate, if:

[(i) each entity:]

[a. either:]

[1. manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;]

[2. manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;]

[3. is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or]

[4. is a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this Rule; and]

(A)[b.] the affiliate is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(B)[c.] [makes] the investment[s] or loan[s] was made subject to the evaluation of individuals who have a contractual or fiduciary duty to select investments and loans based on the risks and rewards to the [entity] affiliate and not based on opportunities for the member participating in the offering to earn investment banking revenues;

(C)[d.] the affiliate does not [participate directly in] receive investment banking fees [received by] paid to any participating member for underwriting public offerings; [and]

(D)[e.] the affiliate, directly or through a subsidiary it controls, is [has been] primarily engaged in the business of making investments in or loans to other companies or is an entity that has been newly formed by such affiliate; and

(E) the affiliate either:

i. manages capital contributions or commitments of $100 million or more, at least $75 million of which has been contributed or committed by persons that are not participating members;

ii. manages capital contributions or commitments of $25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;

iii. is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or

iv. is a bank.

[(ii) all entities related to each member in acquisitions that qualify for this exception do not acquire more than 25% of the issuer's total equity securities during the review period in paragraph (d)(1), calculated immediately following the transaction.]

(2[B]) Investments in and Loans to Certain Issuers — Securities of the issuer purchased in a private placement or received as compensation [for] in connection with the provision of a loan or credit facility before the required filing date of the public offering pursuant to paragraph [(b)(4)](a) [above] by [certain entities] a participating member's affiliate if:

(A[i]) the affiliate[each entity]:

(i)[a.] manages capital contributions or commitments of at least $50 million;

(ii)[b.] is a separate and distinct legal person from any member participating in the offering and is not registered as a broker-dealer;

(iii)[c.] does not [participate directly in] receive investment banking fees paid to any participating [received by the] member for underwriting public offerings; and

(iv)[d.] directly or through a subsidiary it controls, is [has been] primarily engaged in the business of making investments in or loans to other companies or is an entity that has been newly formed by such affiliate; [and]

(B[ii]) institutional investors beneficially own at least 33% of the issuer's total equity securities, calculated immediately prior to the transaction; and

(C[iii]) the transaction was approved by a majority of the issuer's board of directors (if the issuer has a board of directors) and a majority of any institutional investors, or the designees of institutional investors, that are board members.[; and]

[(iv) all entities related to each member in acquisitions that qualify for this exception do not acquire more than 25% of the issuer's total equity securities, calculated immediately following the transaction.]

(3[C]) Private Placements with Institutional Investors — Securities of the issuer purchased in, or received as [placement agent] compensation for services provided in connection with, a private placement before the required filing date of the public offering pursuant to paragraph [(b)(4) above] (a) if:

(A[i]) institutional investors, none of whom is an affiliate of a member participating in the offering purchase at least 51% of the ["]total number of securities sold in the private placement at the same time and on the same terms[offering" (comprised of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member];

(B[ii]) an institutional investor was the lead negotiator or, if the terms were not negotiated, was the lead investor with the issuer to establish or approve the terms of the private placement; and

(C[iii]) [underwriters and related persons] the participating members did not, in the aggregate, purchase or receive as [placement agent] compensation more than [2]40% of the "total number of securities sold in the private placement[offering]" (excluding purchases by any [entity] affiliate qualified under paragraph [(d)(5)(A) above] (d)(1).

(4) Co-Investments with Certain Regulated Entities — Securities of the issuer acquired in a private placement before the required filing date of the public offering pursuant to paragraph (a) by a participating member if at least 15% of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more entities that is an open-end investment company not traded on an exchange, and no such entity is an affiliate of a FINRA member participating in the offering.

[(D) Acquisitions and Conversions to Prevent Dilution — Securities of the issuer if:]

[(i) the securities were acquired as the result of:]

[a. a right of preemption that was granted in connection with securities that were purchased either:]

[1. in a private placement and the securities are not deemed by FINRA to be underwriting compensation; or]

[2. from a public offering or the public market; or]

[b. a stock-split or a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired more than 180 days before the required filing date of the public offering pursuant to paragraph (b)(4) above; or]

[c. the conversion of securities that have not been deemed by FINRA to be underwriting compensation; and]

[(ii) the only terms of the purchased securities that are different from the terms of securities purchased by other investors are pre-existing contractual rights that were granted in connection with a prior purchase;]

[(iii) the opportunity to purchase in a rights offering or pursuant to a right of preemption, or to receive additional securities as the result of a stock-split or conversion was provided to all similarly situated security holders; and] [(iv) the amount of securities purchased or received did not increase the recipient's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment, except in the case of conversions and passive increases that result from another investor's failure to exercise its own rights.]

[(E) Purchases Based On A Prior Investment History — Purchases of securities of the issuer if:]

[(i) the amount of securities purchased did not increase the purchaser's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and]

[(ii) an initial purchase of securities of the issuer was made at least two years and a second purchase was made more than 180 days before the required filing date of the public offering pursuant to paragraph (b)(4) above.]

[(g)]<u>(e)</u> Lock-Up Restriction on Securities

(1) Lock-Up Restriction

<u>(A)</u> [In any public equity offering, other than a public equity offering by an issuer that can meet the requirements in paragraph (b)(7)(C)(i) or (ii) any common or preferred stock, options, warrants, and

other equity securities of the issuer, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered and acquired by an underwriter and related person during 180 days prior to the required filing date, or acquired after the required filing date of the registration statement and deemed to be] Any underwriting compensation consisting of securities [by FINRA, and securities excluded from underwriting compensation pursuant to paragraph (d)(5)(A), (B), (C) and (E) above, shall not be sold during the offering, or] must not be sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities [by any person] for a period of 180 days [immediately following] beginning on the date of [effectiveness or] commencement of sales of the public equity offering, except as provided in paragraph (e)(2)[(g)(2) below].

(B) The lock-up restriction must be disclosed in the section on distribution arrangements in the prospectus or similar document.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (e)(1)[(g)(1) above, the following shall not be prohibited]:

(A) the [transfer of any security] lock-up restriction will not apply:

(i) if the security is required to be transferred by operation of law or by reason of reorganization of the issuer;

(ii[i]) if the aggregate amount of securities of the issuer [held] beneficially owned by [the underwriter and related persons] a participating member does not exceed 1% of the securities being offered;

(iii) to a security of an issuer that meets the registration requirements of SEC Registration Forms S-3, F-3 or F-10;

(iv) to a non-convertible or non-exchangeable debt security acquired in a transaction related to the public offering;

(v) to a derivative instrument acquired in connection with a hedging transaction related to the public offering and at a fair price;

(vi) if the security was acquired in a transaction that met the requirements of paragraph (d);

([i]vii) [that] if the security is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that no participating member manages or otherwise directs investments by the fund, and participating members in the aggregate do not own more than 10% of the equity in the fund; or

(viii) if the security was received as underwriting compensation, and is registered and sold as part of a firm commitment offering.

[(v) that is not an item of value under paragraphs (c)(3)(B)(iii) through (vii) above;]

[(vi) that is eligible for the limited filing requirement in paragraph (b)(6)(A)(iv)b. and has not been deemed to be underwriting compensation under the Rule;]

[(vii) that was previously but is no longer subject to the lock-up restriction in paragraph (g)(1) above in connection with a prior public offering (or a lock-up restriction in the predecessor rule), provided that if the prior restricted period has not been completed, the security will continue to be subject to such prior restriction until it is completed; or]

[(viii) that was acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A; or]

(B) the following will not be prohibited:

[(A)(ii)](i) the transfer of any security to any member participating in the offering and its officers or partners, [thereof] its registered persons or affiliates, if all transferred securities [so transferred] remain subject to the lock-up restriction in paragraph (e)(1)[(g)(1) above] for the remainder of the [time] 180-day lock-up period;

(ii) the exercise or conversion of any security, if all securities received remain subject to the lock-up restriction in paragraph (e)(1)[(g)(1) above] for the remainder of the [time] 180-day lock-up period; or

(iii) the transfer or sale of the security back to the issuer in a transaction exempt from registration with the SEC.

[(h)](f) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" as used in this paragraph ([i]f) shall have the following meanings:

(A) “Compensation” shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of securities that is not cash compensation, including, but not limited to, merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors[1] and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by paragraph [(h)(2)]<u>(f)(2)</u>(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

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1 The current annual amount fixed by the Board of Governors is $100.

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by paragraph [(h)(2)](f)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in paragraph [(h)(2)](f)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by paragraphs [(h)(2)](f)(2)(C) through (E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with paragraphs [(h)(2)](f)(2)(C) through (E).

[(f)](g) Unreasonable Terms and Arrangements

[(2) Prohibited Arrangements]

Without limiting the [foregoing] requirements of paragraph (a)(1)(A), the following terms and arrangements are prohibited[, when proposed in connection with a public offering of securities, shall be unfair and unreasonable.]:

(1) receipt of any underwriting compensation, including in the form of securities, for which a value cannot be determined;

(2[A]) [A]any accountable expense allowance [granted by an issuer to the underwriter and related persons] that includes payment for general overhead, salaries, supplies, or similar expenses [of the underwriter] incurred in the normal conduct of business[.];

(3[B]) [A]any non-accountable expense allowance in excess of 3% of offering proceeds[.];

(4[C]) [A]any [payment of commissions or reimbursement of expenses directly or indirectly to the underwriter and related persons] underwriting compensation paid prior to the commencement of [the public] sales of the [securities being offered] public offering, except: [a reasonable]

(A) an advance against [out-of-pocket] accountable expenses actually anticipated to be incurred [by the underwriter and related persons], which [advance is] must be reimbursed to the issuer to the extent not actually incurred[.]; or

(B) advisory or consulting fees for services provided in connection with the offering that subsequently is completed according to the terms of an agreement entered into by an issuer and a participating member;

(5[D]) [A]any underwriting compensation [by an issuer to a member or person associated with a member] in connection with a[n] public offering [of securities] that is not completed according to the terms of an agreement [between] entered into by an [the] issuer and [underwriter] a participating member, except:

(A[i]) the reimbursement of [out-of-pocket] accountable[, bona fide] expenses actually incurred by the participating member [or person associated with a member]; and

(B[ii]) a termination fee or a right of first refusal, as set forth in a written agreement [between] entered into by an [the] issuer and [the] a participating member, provided that:

(i)[a.] the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement;

(ii)[b.] an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal;

(iii)[c.] the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv)[d.] the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer;[.]

(6[E]) [A]any right of first refusal [provided to the underwriter or related persons] to [underwrite or] participate in the distribution of a future public offering[s], private placement[s] or other financing[s] that:

(A[i]) has a duration of more than three years from the [date of] commencement of sales of the public offering or the termination date of the engagement between the issuer and [underwriter] member; or

(B[ii]) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee[.];

(7[F]) [A]any payment or fee to waive or terminate a right of first refusal [regarding] to participate in a future public offering[s], private placement[s] or other financing[s provided to the underwriter and related persons] that[:]

[(i) has a value in excess of the greater of 1% of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of 1% if additional compensation is available under the compensation guideline of the original offering) or 5% of the underwriting discount or commission paid in connection with the future financing (including any overallotment option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering; or]

[(ii)] is not paid in cash[.];

(8[G]) [The terms or the exercise of the terms of an agreement for] the receipt [by the underwriter and related persons] of underwriting compensation consisting of any option, warrant or convertible security that:

(A[i]) is exercisable or convertible more than five years from the [effective date] commencement of sales of the public offering;

[(ii) is not in compliance with paragraph (e)(1) above;]

(B[iii]) has more than one demand registration right at the issuer's expense;

(C[iv]) has a demand registration right with a duration of more than five years from [the date of effectiveness or] the commencement of sales of the public offering;

(D[v]) has a piggyback registration right with a duration of more than seven years from the [date of effectiveness or the] commencement of sales of the public offering;

(E[vi]) has anti-dilution terms that allow the [underwriter and related persons] participating members to receive more shares or to exercise at a lower price than originally agreed upon at the time of the public offering, when the public shareholders have not been proportionally affected by a stock split, stock dividend, or other similar event; or

(F[vii]) has anti-dilution terms that allow the [underwriter and related persons] participating members to receive or accrue cash dividends prior to the exercise or conversion of the security[.];

[(H) The receipt by the underwriter and related persons of any item of compensation for which a value cannot be determined at the time of the offering.]

(9[I]) [W]when proposed in connection with the distribution of a public offering of securities on a "firm commitment" basis, any overallotment option providing for the overallotment of more than 15% of the amount of securities being offered, computed excluding any securities offered pursuant to the overallotment option[.];

(10[J]) [T]the receipt by a participating member [or person associated with a member, pursuant to an agreement entered into at any time before or after the effective date of a public offering of warrants, options, convertible securities or units containing such securities,] of any compensation [or expense reimbursement] in connection with the exercise or conversion of any [such] warrant, option, or convertible security [in any of the following circumstances] offered in the public offering if:

(A[i]) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

(B[ii]) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion, except where

prior specific written approval for exercise or conversion is received from the customer;

(C[iii]) the compensation arrangements [whereby compensation is to be paid] are not disclosed[:]

[a. in the prospectus or offering circular by which the warrants, options, or convertible securities are offered to the public, if such arrangements are contemplated or any agreement exists as to such arrangements at that time, and]

[b.] in the [prospectus or] offering [circular] documents provided to security holders at the time of exercise or conversion; [or]

(D[iv]) the exercise or conversion [of the warrants, options or convertible securities] is not solicited by the [underwriter or related person] participating members[, provided however, that any request for exercise or conversion will be presumed to be unsolicited unless the customer states in writing that the transaction was solicited and designates in writing the broker-dealer to receive compensation for the exercise or conversion.]; and

(11[K]) [F]for a member to participate with an issuer in the public offering [distribution of a non-underwritten issue] of securities if the issuer hires persons primarily for the purpose of solicitation, marketing, distribution or sales of the offering [distributing or assisting in the distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting], except [to the extent] in compliance with Section 15(a) of the Exchange Act or SEA Rule 3a4-1 and applicable state law.

(h) Exemptions

[(b)(7)](1) Offerings Exempt from Filing

[Notwithstanding the provisions of subparagraph (1) above, d]Documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of Rule 5121(a)(2)[.], provided that the following public offerings must comply with this Rule and, if applicable, Rules 2310 and 5121[. However, it shall be deemed a violation of this Rule or Rule 2310, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or Rule 2310, as applicable]:

(A) securities offered by a [corporate] bank, corporate issuer, foreign government or foreign government agency [issuer which] that has unsecured non-convertible debt with a term of issue of at least four [(4)] years[,] or unsecured non-convertible preferred securities[,] that are investment grade rated [by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories], as defined in Rule 5121(f)(8), or are securities in the same series that have equal rights and obligations as investment grade rated securities, provided [except] that an [the] initial public offering of [the] equity [of an issuer] is required to be filed;

(B) investment grade rated non-convertible debt securities and non-convertible preferred securities [rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories];

(C) offerings of securities[:]

[(i)] registered with the SEC on registration statement Forms S-3, [or] F-3 [pursuant to the standards for those Forms prior to October 21, 1992 and offered pursuant to Rule 415 of SEC Regulation C], or F-10, provided that the registrant is an experienced issuer;

[(ii) of a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory, and is registered with the SEC on Form F-10 pursuant to the standards for that Form approved in Securities Act Release No. 6902 (June 21, 1991) and offered pursuant to Canadian shelf prospectus offering procedures;]

(D) [securities offered pursuant to a redemption standby "firm commitment" underwriting arrangement registered with the SEC on Forms S-3, F-3 or F-10 (only with respect to Canadian issuers);]

[(E)] investment grade rated financing instrument-backed securities [which are rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories];

(E[F]) exchange offers [of securities] where:

(i) the securities to be issued or the securities of the company being acquired are listed, or convertible into securities that are listed, on a national securities exchange as defined in Section 6 of the Exchange Act[The Nasdaq Global Market, the New York Stock Exchange, or the American Stock Exchange]; or

(ii) the company issuing securities qualifies to register securities with the SEC on registration statement Forms S-3, F-3, or F-10 and is an experienced issuer[, pursuant to the standards for those Forms as set forth in subparagraph (C)(i) and (ii) of this paragraph];

(F[G]) public offerings of securities by a church or other charitable institution that is exempt from SEC registration pursuant to Section 3(a)(4) of the Securities Act; and

(G[H]) offerings of securities issued by a pooled investment vehicle, whether formed as a trust, partnership, corporation, limited liability company or other collective investment vehicle, that is not registered as an investment company under the Investment Company Act and has a class of equity securities listed for trading on a national securities exchange and that[; provided that such equity securities] may be created or redeemed on any business day at their net asset value per share.

[(b)(8)](2) [Exempt] Offerings Not Subject to Filing and Rule Compliance

[Notwithstanding the provisions of subparagraph (1) above, the following offerings are exempt from this Rule, Rule 2310, and Rule 5121. Documents and information relating to the following offerings need not be filed for review:]

The following offerings are not subject to this Rule, Rule 2310 and Rule 5121 including not being required to file documents and information for review:

(A[C]) securities of "open-end" investment companies as defined in Section 5(a)(1) of the Investment Company Act;

(B) [and]securities of any "closed-end" investment company as defined in Section 5(a)(2) of the Investment Company Act that[:]

[(i)] makes periodic repurchase offers pursuant to Rule 23c-3(b) under the Investment Company Act[;] and

[(ii)] offers its shares on a continuous basis pursuant to Rule 415(a)(1)(xi) of SEC Regulation C;

(C[D]) variable contracts as defined in Rule 2320(b)(2);

(D[E]) modified guaranteed annuity contracts and modified guaranteed life insurance policies, which are deferred annuity contracts or life insurance policies the value of which are guaranteed if held for specified periods, and the nonforfeiture value of which are based upon a market-value adjustment formula for withdrawals made before the end of any specified period;

(E) insurance contracts not otherwise included in paragraph (h)(2)(C) and (D);

(F) [offerings of] municipal securities as defined in Section 3(a)(29) of the Exchange Act;

(G) tender offers made pursuant to SEC Regulation 14D under the Exchange Act;

(H) securities issued pursuant to a competitively bid underwriting arrangement meeting the requirements of the Public Utility Holding Company Act;

(I) securities of a subsidiary or other affiliate distributed by a company in a spin-off or reverse spin-off or similar transaction to its existing security holders exclusively as a dividend or other distribution; [and]

(J) securities registered with the SEC in connection with a merger or acquisition transaction or other similar business combination, except for any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; [offerings required to be filed pursuant to subparagraph (9)(I) below.]

(K) securities of a unit investment trust as defined in Section 4(2) of the Investment Company Act; and

(L) offerings of securities by a “closed-end” investment company as defined in Section 5(a)(2) of the Investment Company Act that is operated as a tender offer fund, provided that the fund:

(i) makes continuous offerings pursuant to Securities Act Rule 415;

(ii) prices its securities at least quarterly;

(iii) limits the total amount of compensation paid to participating members to the amount permitted by the sales charge limitations of Rule 2341, in which case the underwriting compensation provisions of Rule 5110 will not apply;

(iv) makes at least two repurchase offers per calendar year for its securities pursuant to SEA Rule 13e-4 and Schedule TO under the Exchange Act; and

(v) does not list its securities on a national securities exchange.

(i) Requests for Rule 9600 Exemption[s] from Rule 5110

Pursuant to the Rule 9600 Series, [the appropriate] FINRA [staff], for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest.

[(a)](j) Definitions

[For purposes of this Rule, the following terms shall have the meanings stated below.] The definitions in Rule 5121 are incorporated herein by reference. For purposes of this Rule, the following terms have the meanings stated below:

(1) Associated Person

The term "associated person" has the meaning defined in Article I, Section (rr) of the FINRA By-Laws.

[(2) Net Offering Proceeds]

[Offering proceeds less all expenses of issuance and distribution.]

[(d)(4)(C)**](2) Bank**

[A bank or insurance company is] The term "bank" means a bank as defined in Section 3(a)(6) of the Exchange Act or is a foreign bank that has been granted an exemption under this Rule and shall refer only to the regulated entity, not its subsidiaries or other affiliates.

[(11)](3) Company

The term "company" means a [A] corporation, a partnership, an association, a joint stock company, a trust, a fund, or an[y] organized group of persons whether incorporated or not; [or] including any receiver, trustee in bankruptcy or similar official, or [any] liquidating agent [for] of any of the foregoing[, in his capacity as such].

(4) Compensation

The term "compensation" means cash compensation and non-cash compensation.

[(12)](5) Effective Date

The term "effective date" means t[T]he date on which an issue of securities [first] becomes legally eligible for distribution to the public.

(6) Experienced Issuer

The term “experienced issuer” means an entity that has:

(A) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and

(B) at least $150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is $100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.

[(6) Underwriter and Related Persons]

[Consists of underwriter's counsel, financial consultants and advisors, finders, any participating member, and any other persons related to any participating member.]

[(7) Listed Securities]

[Securities meeting the listing standards to trade on the national securities exchanges identified in Securities Act Rule 146, markets registered with the SEC under Section 6 of the Exchange Act, and any offshore market that is a "designated offshore securities market" under Rule 902(b) of SEC Regulation S.]

[(8) Derivative Instruments]

[A derivative instrument is any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3).]

[(9) Fair Price]

[A derivative instrument or non-convertible or non-exchangeable debt security has been acquired or entered into at a fair price for purposes of paragraphs (b)(6)(A)(iv), (c)(3)(B)(vi) and (vii), and (e)(5) if the underwriters and related persons have priced the debt security or derivative instrument in good faith; on an arm's length, commercially reasonable basis; and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services, is not included within this "fair price" definition.]

<u>(7) Equity-Linked Securities</u>

<u>The term “equity-linked securities” means any security that is convertible or exchangeable into an equity security.</u>

[(13)]<u>(8)</u> Immediate Family

[The parents, mother-in-law, father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or associated person of a member. In addition, the immediate family includes any other person who either lives in the same household as, provides material support to, or receives material support from, an employee or associated person of a member.]

<u>The term “immediate family” means:</u>

<u>(A) the spouse or child of an associated person of a member; and</u>

(B) any relative who either lives in the same household as, has a business relationship with, provides material support to, or receives material support from, an associated person of a member, including, but not limited to, a parent, sibling, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, or daughter-in-law.

[(5)(B)**](9) Independent Financial Adviser**

[For purposes of this provision, an "independent financial adviser" is] The term "independent financial adviser" means a member or a person affiliated or associated with a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated or associated with any entity that is engaged in, the solicitation or distribution of the offering.

[(d)(4)(B)**](10) Institutional Investor**

For the purposes of paragraph (d), the term [An] "institutional investor" [is] means any [individual or legal] person that has an aggregate of at least $50 million invested in securities [in the aggregate] in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members [direct or otherwise] manage the institutional investor's investments or have an equity interest in the institutional investor, either individually or in the aggregate, that exceeds 5% for a publicly owned entity or 1% for a nonpublic entity.

(11) Insurance Company

For the purposes of paragraph (d), the term "insurance company" refers only to the regulated entity, not its subsidiaries or other affiliates.

[(1)](12) Issuer

[The issuer of the securities offered] The term "issuer" means a registrant or other person that is offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant or such other person [issuer] or selling security holder, and the officers or general partners, and directors[, employees and security holders] thereof.

[(3)](13) Offering Proceeds

[Public offering price] The term "offering proceeds" means the proceeds of all the securities offered [to] in the public offering by participating members, not including securities subject to an[y] overallotment option, securities to be received by the [underwriter and related persons] participating members, or [securities] underlying [other] securities.

(14) Overallotment Option

The term "overallotment option" means an option granted by the issuer to the participating members for the purpose of offering additional shares to the public in connection with the distribution of the public offering.

[(4)](15) Participating Member[(s)]

The term "participating member" means a[A]ny FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any [members of their] immediate family, but does not include the issuer[, and any affiliate of the member].

[(5)](16) Participate, Participation or Participating [in a Public Offering]

The terms “participate,” “participation” or “participating” in a public offering means involvement [Participation] in the preparation of the offering document or other documents, [participation] involvement in the distribution of the offering [on an underwritten, non-underwritten, or any other basis], furnishing of customer [and/]or broker lists for solicitation, or [participation in any] providing advisory or consulting [capacity] services to the issuer related to the offering, but do not include:

(A) the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEA Rule 13e-3; [or] and

(B) advisory or consulting services provided to the issuer by an independent financial adviser, provided that another member or members is participating in the public offering.

[(14)](17) Person

The term “person” means a[A]ny natural person, partnership, corporation, company, association, or other legal entity.

(18) Public Offering

The term "public offering" means any primary or secondary offering of securities made in whole or in part in the United States pursuant to a registration statement, offering circular or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition except for:

[(b)(8)](A) securities exempt from registration with the SEC pursuant to the provisions of Sections 4(a)(1), 4(a)(2) or 4(a)(6) of the Securities Act; [or]

(B) securities exempt from registration with the SEC pursuant to Rule 504 of SEC Regulation D if the securities are ["]restricted securities["] under Securities Act Rule 144(a)(3)[, Rule 505 of SEC Regulation D,] or Rule 506 of SEC Regulation D;

(C) securities exempt from registration with the SEC pursuant to Securities Act Rule 144A or SEC Regulation S; or

(D[B]) securities which are defined as "exempted securities" in Section 3(a)(12) of the Exchange Act.[as amended;]

[(10)](19) Required Filing Date

(A) The term "required filing date" [shall be] means the dates [provided] referenced in paragraph (a)(3)[(b)(4),]; and

(B) F[f]or a public offering exempt from filing under paragraph [(b)(7)](h), the term "required filing date" [for purposes of paragraphs (d) and (g) shall be] means the date the public offering would have been required to be filed with FINRA but for the exemption.

(20) Review Period

The term "review period" means:

(A) for a firm commitment offering, the 180-day period preceding the required filing date through the 60-day period following the effective date of the offering;

(B) for a best efforts offering, the 180-day period preceding the required filing date through the 60-day period following the final closing of the offering; and

(C) for a firm commitment or best efforts takedown or any other continuous offering made pursuant to Securities Act Rule 415, the 180-day period preceding the required filing date of the takedown or continuous offering through the 60-day period following the final closing of the takedown or continuous offering.

[(d)(4)(E)**](21) Total Equity Securities**

For the purposes of paragraph (d), the term "[T]total equity securities" means the aggregate of the total shares of:

(A[i]) common stock outstanding of the issuer; and

(B[ii]) common stock of the issuer underlying all convertible securities outstanding that convert without the payment of any additional consideration.

(22) Underwriting Compensation

The term "underwriting compensation" means 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. In addition, underwriting compensation shall include finder's fees, underwriter's counsel fees, and securities.

• • • Supplementary Material: --------------

.01 Underwriting Compensation

(a) The following are examples of payments or benefits that are considered underwriting compensation:

(1) discounts or commissions;

(2) fees and expenses paid or reimbursed to, or paid on behalf of, the participating members, including but not limited to road show fees and expenses and due diligence expenses;

(3) fees and expenses of participating members' counsel paid or reimbursed to, or paid on behalf of, the participating members (except for reimbursement of "blue sky" fees);

(4) finder's fees paid or reimbursed to, or paid on behalf of, the participating members;

(5) wholesaling fees and expenses;

(6) financial consulting and advisory fees;

(7) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, beneficially owned, as defined in Rule 5121 by the participating members the value of which is determined pursuant to this Rule, and acquired during the review period, as defined in this Rule;

(8) sales incentive items;

(9) any right or rights of first refusal provided to any participating member to participate in future public offerings, private placements or other financings, the value of which will be 1% of the offering proceeds or a dollar amount contractually agreed to by the issuer and the participating member to waive the right of first refusal;

(10) compensation to be received by a participating member or by any person nominated by the participating member as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors;

(11) any compensation to be received by the participating members as a result of the exercise or conversion of warrants, options, convertible securities, or similar securities distributed as part of the public offering within 12 months following the commencement of sales;

(12) fees of a qualified independent underwriter required by Rule 5121;

(13) any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering; and

(14) non-cash compensation, such as gifts, training and education expenses, sales incentives, and business entertainment expenses.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) printing costs; SEC, "blue sky" and other registration fees; FINRA filing fees; fees of independent financial advisers; and accountant's fees, and other fees and expenses customarily borne by an issuer, whether or not paid by or through a participating member;

(2) cash compensation for providing services for a private placement or for providing or arranging for a loan, credit facility, or for services in connection with a merger or acquisition;

(3) records management and advisory fees and expenses in connection with the conversion of the issuer from a mutual holding company to a stock holding company;

(4) payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer;

(5) compensation for providing brokerage, trust and insurance services to the issuer that is received in the ordinary course of business;

(6) fees for commercial banking services, which does not require registration as a broker-dealer, provided to the issuer in the ordinary course of business;

(7) compensation for providing services in a prior or concurrent public offering separately filed or exempt from filing pursuant to this Rule;

(8) a right of first refusal that is provided to a participating member in connection with a prior financing if the right of first refusal does not extend beyond the initial closing of the public offering currently under review or if the

right of first refusal has already been included as underwriting compensation in a prior or concurrent public offering;

(9) dividends paid to shareholders of a class of the issuer's securities when participating members are shareholders of that class;

(10) securities of the issuer pledged as collateral for a bona fide loan;

(11) listed securities purchased in public market transactions;

(12) compensation received through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code or a similar plan;

(13) securities acquired by an investment company registered under the Investment Company Act;

(14) securities acquired as the result of a conversion of securities that were originally acquired prior to the review period;

(15) securities acquired as the result of an exercise of options or warrants that were originally acquired prior to the review period;

(16) securities acquired as the result of a stock-split, a pro-rata rights or similar offering where the securities upon which the acquisition is based were acquired prior to the review period;

(17) securities acquired as the result of a right of preemption that was granted prior to the review period;

(18) securities acquired in order to prevent dilution of a long-standing interest in the issuer, if:

(A) the amount of securities does not increase a member's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and

(B) an initial purchase of securities of the issuer was made at least two years preceding the required filing date and a second purchase was made before the review period;

(19) non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) securities acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A;

(21) securities acquired in the secondary market by a participating member that is a broker-dealer in connection with the performance of bona fide customer facilitation activities; provided that securities acquired from the issuer will be considered "underwriting compensation" if the securities were not acquired at a fair price (taking into account, among other things customary commissions, mark-downs and other charges); and

(22) securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding).

(c) Definitions

(1) The term "listed securities" means securities that are traded on the national securities exchanges identified in Securities Act Rule 146, on markets

registered with the SEC under Section 6 of the Exchange Act, and on any "designated offshore securities market" as defined in Rule 902(b) of SEC Regulation S.

(2) The term “right of pre-emption” means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to: (A) any option, shareholder agreement, or other contractual right entered into at the time of purchase of securities; (B) the terms of the securities purchased; (C) the issuer’s charter or by-laws; or (D) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.

.02 Venture Capital Transactions and Significantly Delayed Offerings.

Notwithstanding paragraph (d), in the event that an offering is significantly delayed and the issuer needs funding pending consummation of the public offering, FINRA may exclude from underwriting compensation any securities acquired in a transaction that otherwise meets the requirements in paragraph (d), but occurs after the required filing date. To determine whether an acquisition of securities that occurs after the required filing date may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the length of time between the required filing of the registration statement or similar document and the date of the transaction in which securities were acquired;

(b) the length of time between the date of the transaction in which the securities were acquired and the anticipated commencement of the public offering; and

(c) the nature of the funding provided, including, but not limited to the issuer's need for funding before the public offering.

.03 Underwriting Compensation Securities Acquired Other than from the Issuer. Notwithstanding paragraph (j)(22), FINRA may exclude securities acquired from a third-party entity from underwriting compensation. To determine whether an acquisition of securities from a third-party entity may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the nature of the relationship between the issuer and the third party, if any;

(b) the nature of the transactions in which the securities were acquired, including, but not limited to, whether the transactions are engaged in as part of the participating member's ordinary course of business; and

(c) any disparity between the price paid and the offering price or market price.

.04 Underwriting Compensation Resulting from Issuer Directed Sales Programs. Notwithstanding paragraph (j)(15) and (22), FINRA may exclude from underwriting compensation securities acquired by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program. To determine whether an acquisition of securities by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) the existence of a pre-existing relationship between the issuer and the person acquiring the securities;

(b) the nature of the relationship; and

(c) whether the securities were acquired on the same terms and at the same price as other similarly-situated persons participating in the directed sales program.

.05 Disclosure of Underwriting Compensation. A description of each item of underwriting compensation received or to be received by a participating member must be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document). The description shall include the dollar amount ascribed to each individual item of compensation. When securities are acquired by a participating member, material terms and arrangements of the acquisition must also be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document) when applicable, such as exercise terms, demand and piggyback registration rights and lock-up periods that may apply. Similarly, if underwriting compensation consists of a right of first refusal to participate in the distribution of a future public offering, private placement or other financing, the description should reference the existence of such right and its duration.

.06 Non-Convertible or Non-Exchangeable Debt Securities and Derivatives

(a) Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation value. Non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule.

(b) The term "derivative instrument" means any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term "fair price" means the participating members have priced a derivative instrument or non-convertible or non-exchangeable debt security in good faith; on an arm's length, commercially reasonable basis, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price.

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5120. Offerings of Members' Securities

5121. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraph[s] (1) or (2).

(1) through (2) No Change.

(b) through (e) No Change.

(f) Definitions

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

(1) through (8) No Change.

(9) Net Offering Proceeds

The term “net offering proceeds” means offering proceeds less all expenses of issuance and distribution.

(10[9]) Preferred Equity

The term "preferred equity" means the aggregate capital invested by all persons in the preferred securities outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(11[0]) Prominent Disclosure

A member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B) by:

(A) through (B) No Change.

[(11) Public Offering]

[The term "public offering" means any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition and all other securities offerings of any kind whatsoever, except any offering made pursuant to:]

[(A) an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act;]

[(B) Securities Act Rule 504, if the securities are "restricted securities" under Securities Act Rule 144(a)(3), Securities Act Rules 505 or 506; or]

[(C) Securities Act Rule 144A or SEC Regulation S.]

[The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Exchange Act.]

(12) Qualified Independent Underwriter

The term "qualified independent underwriter" means a member:

(A) through (D) No Change.

(E) none of whose associated persons who function in a supervisory capacity who is [are] responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) through (iii) No Change.

(13) through (14) No Change.

5122. Private Placements of Securities Issued by Members

(a) through (b) No Change.

(c) Exemptions

The following Member Private Offerings are exempt from the requirements of this Rule:

(1) through (7) No Change.

(8) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(h)(2)(D)[(b)(8)(E)];

(9) through (14) No Change.

(d) through (e) No Change.

• • • Supplementary Material: --------------

No Change.

5123. Private Placements of Securities

(a) No Change.

(b) Exemptions

The following private placements are exempt from the requirements of this Rule:

(1) through (6) No Change.

(7) offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in Rule 5110(h)(2)(D)[(b)(8)(E)];

(8) through (13) No Change.

(14) offerings filed with FINRA under Rules 2310, 5110, 5121 and 5122, or exempt from filing thereunder in accordance with Rule 5110(h)(1)[(b)(7)].

(c) through (d) No Change.

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9200. DISCIPLINARY PROCEEDINGS

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9217. Violations Appropriate for Disposition Under Plan Pursuant to SEA Rule 19d-1(c)(2)

Any member of FINRA that is also a member of the New York Stock Exchange LLC ("NYSE") ("Dual Member") (including any persons affiliated with such member) may be subject to a fine under Rule 9216(b) with respect to any rule or By-Law provision listed in this Rule that applies to such member or person. However, any Dual Member that was not also a member of NASD as of July 30, 2007 and that does not engage in any activities that otherwise would require it to be a FINRA member (and its affiliated persons that are not otherwise subject to NASD rules) shall only be subject to a fine under Rule 9216(b) with respect to the following rules or By-Law provisions listed in this Rule: any FINRA By-Law or Schedule to the By-Laws, FINRA rule, SEA rule, or NYSE rule.

Any member of FINRA that is not also a member of the NYSE (and its associated persons that are not otherwise subject to NYSE rules) may be subject to a fine under Rule 9216(b) with respect to any rule or By-Laws provision listed in this Rule, with the exception of the NYSE rules.

• Article IV of the FINRA By-Laws — Failure to timely submit amendments to Form BD.

• Article V of the FINRA By-Laws — Failure to timely submit amendments to Form U4.

• Article V of the FINRA By-Laws — Failure to timely submit amendments to Form U5.

• Schedule A. Sec. 1(b) of the FINRA By-Laws — Failure to make accurate payment of Trading Activity Fee.

• Rule 1210.04 — Failure to timely register.

• Rule 1240 — Failure to comply with the continuing education requirements.

• Rules 2210, 2211, 2212, 2213, 2215, and 2216 — Communications with the public.

• Rule 2220 — Options Communications.

- Rule 2251(a) — Failure to timely forward proxy and other issuer-related materials.
- Rule 2266 — Failure to provide written notification of availability of SIPC information at account opening or annually thereafter.
- Rule 2360(b)(3) and (b)(4) — Failure to comply with options position and exercise limits.
- Rule 2360(b)(5) — Failure to report options positions.
- Rule 2360(b)(23) — Failure to comply with contrary exercise advice procedures.
- Rule 3110 — Failure to maintain adequate written supervisory procedures where the underlying conduct is subject to Rule 9217.
- Rule 3160(a)(1), (3), (4) and (5) — Standards of conduct for conducting broker-dealer services on or off the premises of a financial institution pursuant to a networking arrangement, but excluding the networking agreement requirements.
- Rule 3170 — Failure to timely file reports pursuant to the Taping Rule.
- Rule 3210 — Failure to obtain consent of employer member, or give notification to executing member.
- Rule 4311(b) — Failure to obtain approval of carrying agreement.
- Rule 4360(b) — Failure to maintain adequate fidelity bond coverage.
- Rule 4370(a), (b), (c), (e) and (f) — Requirements to create, maintain and update a written business continuity plan and disclosure of such to customers.

- Rule 4510 Series — Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with FINRA rules.
- Rule 4517 — Failure to report, review or update executive representative designation and contact information.
- Rule 4521(d) — Failure to submit reports of cash and margin account balances.
- Rule 4524 — Failure to timely file or filing of incomplete reports or information.
- Rule 4530 — Failure to timely file reports.
- Rule 4560 — Failure to timely file reports of short positions on Form NS-1.
- Rule 4590 — Failure to synchronize business clocks used for recording date and time as required by applicable FINRA By-laws and rules.
- Rule 5110(a)[(b)] — Failure to timely file or filing of incomplete documents or information.
- Rule 5121(a) — Failure to prominently disclose conflict of interest.
- Rule 5121(b)(2) — Failure to give timely notification of termination or settlement of public offering, or failure to file net capital computation.
- Rule 5122(b)(2) — Failure to timely file private placement documents.
- Rule 5190 — Failure to give timely notification of participation in offerings.
- Rules 6282, 6380A, 6380B, 6550, 6622, 6730, 7130, 7160, 7230A, 7230B, 7260A, 7260B, 7330, and 7360 — Transaction reporting in equity and debt securities.
- Rules 6181 and 6623 — Failure to timely report transactions in NMS, OTC and restricted equity securities.

- Rules 6182 and 6624 — Failure to accurately mark short sale transactions in NMS and OTC equity securities.
- Rule 6250 — Failure to comply with quote and order access requirements for FINRA's Alternative Display Facility.
- Rule 6760 — Failure to give timely or complete notification concerning offerings of TRACE-Eligible Securities.
- Rules 7440 and 7450 — Failure to submit data in accordance with the Order Audit Trail System ("OATS").
- Rules 8211 and 8213 — Failure to submit trading data as requested.
- Rule 11870 — Failure to abide by Customer Account Transfer Contracts.
- Failure to provide or update contact information as required by FINRA rules.
- Rule 311T(b)(5) — Failure of a member organization to have individuals responsible and qualified for the positions of Financial Principal, Operations Principal, Compliance Official, Branch Office Manager and Supervisory Analyst.
- Rules 312T(a), (b) and (c), 313T— Reporting rule violations.
- Rule 312T(i) — Failure to obtain approval rule violations.
- Rule 408T(a) — Requirement that written authorization be obtained for discretionary power in a customer's account.
- Rule 416AT — Failure to promptly provide or promptly update required membership profile information through the Electronic Filing Platform ("EFP"), or failure to electronically certify that required membership profile information is complete and accurate.
- SEA Rules 17a-3(a) and 17a-4 — Record retention rule violations.

- SEA Rule 10b-10 — Confirmation of Transactions.
- SEA Rule 17a-5 — Failure to timely file FOCUS reports and annual audit reports.
- SEA Rule 17a-10 — Failure to timely file Schedule I.
- Rule 200(g) of SEC Regulation SHO — Failure to accurately mark sell orders of equity securities.
- Rule 602(b)(5) of SEC Regulation NMS — Failure to properly update published quotations in certain Electronic Communication Networks ("ECNs").
- Rule 604 of SEC Regulation NMS — Failure to properly display limit orders.
- Rule 605(a)(1) and (3) of SEC Regulation NMS — Failure to timely report or provide complete order execution information.
- Rule 606 of SEC Regulation NMS — Failure to timely disclose or provide complete order routing information.
- MSRB Rule A-12(c) and (f) — Failure to timely pay annual fee and failure to designate and update electronic mail contact information for communications with MSRB.
- MSRB Rules G-2 and G-3 (b)(ii)(D) and (c)(ii)(D) — Failure to timely register.
- MSRB Rule G-3(i) — Failure to comply with the continuing education requirements.
- MSRB Rule G-6 — Failure to maintain adequate fidelity bond coverage.
- MSRB Rules G-8 and G-9 — Record retention rule violations.
- MSRB Rule G-10(a) — Failure to deliver investor brochure to customers promptly.

- MSRB Rule G-12 — Failure to abide by uniform practice rules.
- MSRB Rule G-14 — Failure to submit reports.
- MSRB Rule G-21 — Advertising.
- MSRB Rule G-27(c) — Failure to maintain adequate written supervisory procedures where the underlying conduct is subject to Rule 9217.
- MSRB Rule G-32 — Failure to timely submit reports.
- MSRB Rule G-37 — Failure to timely submit reports for political contributions.

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