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.

---

[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

---

[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.

---

[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

---

[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.

---

[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

---

[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. 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))

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*, or as permitted elsewhere in this Rule*."

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

---

[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.

[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

---

[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

[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]

---

[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.

---

[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:

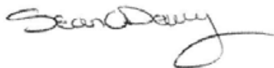
> "A derivative instrument or other security received *as compensation* for acting as a private placement agent for the issuer, for providing a loan, credit facility, merger, acquisition or any other service, including underwriting services, *will not be deemed to have been entered into or acquired at 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,



Sean Davy
Managing Director
Capital Markets Division
SIFMA
(212) 313-1118
sdavy@sifma.org

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
Jeanette Wingler, Associate General Counsel, Office of General Counsel