FOR FURTHER INFORMATION CONTACT: Christopher C. Meyerson, (202) 268–7820.

SUPPLEMENTARY INFORMATION: The United States Postal Service® hereby gives notice that, pursuant to 39 U.S.C. 3642, on April 24, 2019, it filed with the Postal Regulatory Commission a *Request of The United States Postal Service to add Global Expedited Package Services 11 to the Competitive Products List.* Documents are available at *www.prc.gov,* Docket Nos. MC2019–132 and CP2019–142.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–85715; 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

April 25, 2019.

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 April 11, 2019, 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 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 the 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 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

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

[2] 17 CFR 240.19b–4.

[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).

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

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 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-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 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 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

[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).

[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).

[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).

[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).

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.

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 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 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 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]

[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).

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

[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.

[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).

[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.

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 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 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 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 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

[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.

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

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

[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.

[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.*

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 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. 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.

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 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

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

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

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

[41] *See* proposed Supplementary Material .01(b)(14), (16–18).

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

[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).

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 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 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 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]

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

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

[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.

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

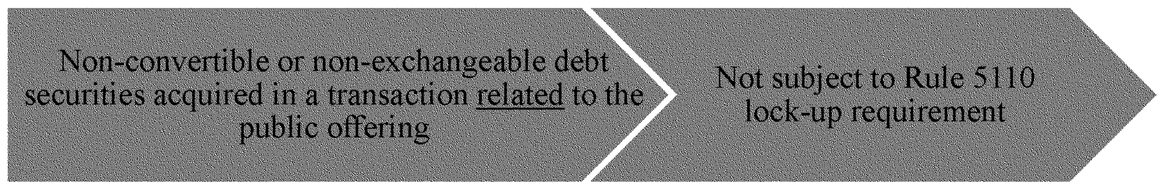
[49] *See* proposed Rule 5110(a)(4)(B)(iv)b.

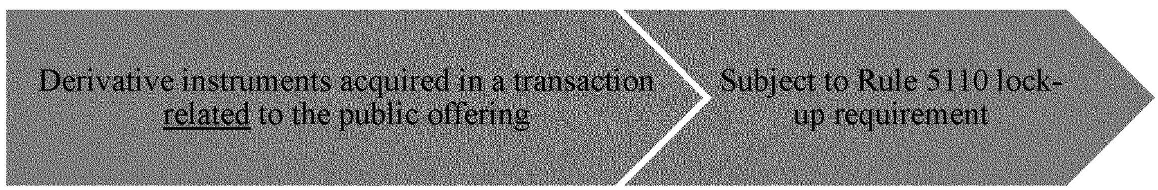
[50] *See* proposed Rule 5110(a)(4)(B)(iv)a. Generally consistent with current Rule 5110, the proposed rule change would define the term ''fair price'' to

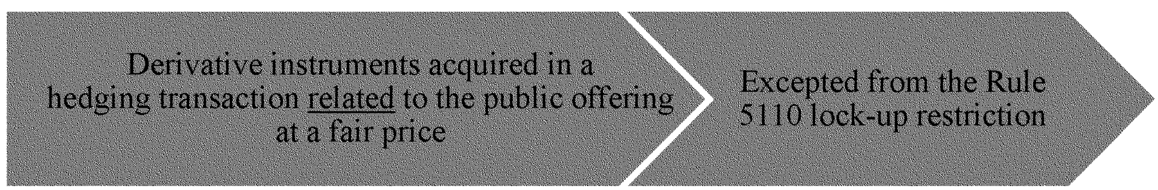
Continued

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.







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 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

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 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).

[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).

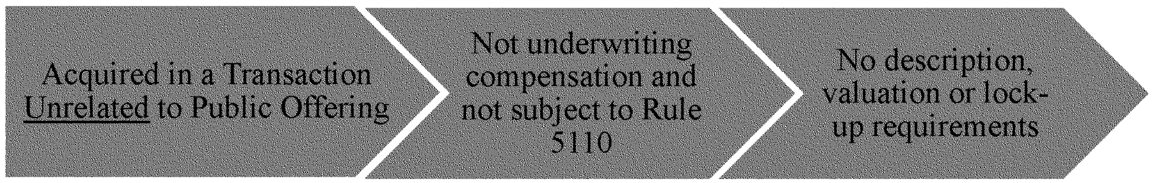
[55] *See* proposed Rule 5110(e)(2)(A)(iii).

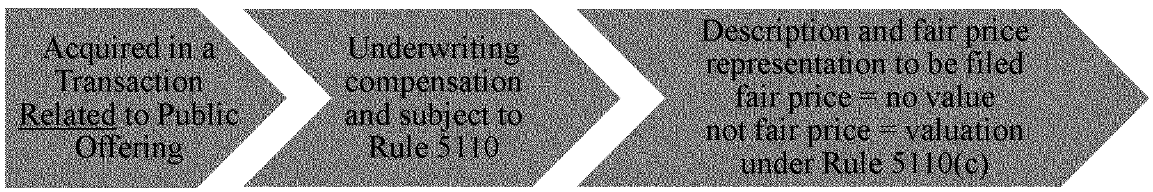
[56] *See* proposed Rule 5110(e)(2)(A)(vi).

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

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.





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 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 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

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

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

[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."

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

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

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, 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 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 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 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.

The proposed rule change would facilitate capital formation by

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

[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).

[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).

[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).

[75] *See* proposed Rule 5110(c).

[76] 15 U.S.C. 78*o*–3(b)(6).

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. 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] 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]

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

[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 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.

[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.

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]

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 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 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]

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

[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).

[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.

[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).

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

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]

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.

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.

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. 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

[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.

[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).

[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.

[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).

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

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.

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).

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 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

[97] *See* ABA, NASAA, Rothwell and Sullivan.

[98] *See* ABA, ADISA and SIFMA.

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

[100] *See* ABA and SIFMA.

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.

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. 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

[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).

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.

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 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 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 underwriting compensation.[110] The proposed rule

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

[104] *See* proposed Rule 5110(h)(1)(A).

[105] *See* proposed Rule 5110(h)(2)(E).

[106] *See* proposed Rule 5110(h)(2)(K).

[107] *See* Energy Policy Act of 2005, Public Law 109–58, 119 Stat. 594 (2005).

[108] *See* proposed Rule 5110(h)(2)(H).

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

[110] *See* proposed Rule 5110(b)(1) and Supplementary Material .05 to Rule 5110. *See also*

Continued

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]

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 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 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 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

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 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).

[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.''

[119] *See* EGS and Rothwell.

[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.

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 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 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]

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

[121] *See* ABA and SIFMA.

[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).

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 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 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]

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

[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.

[126] *See* ABA and SIFMA.

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

[128] *See* ABA, Davis Polk and Rothwell.

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

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.

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

[130] *See* proposed Rule 5110(d)(1)(B).

[131] *See* ABA and SIFMA.

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 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 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

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

[133] *See* ADISA, Rothwell and SIFMA.

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

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 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

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

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

[137] *See* ABA and SIFMA.

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.

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 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 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

[138] *See* proposed Rule 5110(j)(18).

[139] *See supra* discussion of previous problems associated with shelf offerings in Item II.A.

[140] *See* Davis Polk and SIFMA.

[141] *See* ABA and Rothwell.

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

[143] *See* ABA, Rothwell and SIFMA.

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 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.

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

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

[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.

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 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 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.

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 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

[146] *See* Rothwell and SIFMA.

[147] *See Notice to Members* 92–28 (May 1992).

[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).

[149] *See* ABA and SIFMA.

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 up to 90 days (i) as the Commission may designate 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 email 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 email 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 10:00 a.m. and 3:00 p.m. Copies of the 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 May 22, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[150]

Eduardo A. Aleman,

Deputy Secretary.

[FR Doc. 2019–08774 Filed 4–30–19; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–85723; File No. SR–NYSENAT–2019–10]

Self-Regulatory Organizations; NYSE National, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 7.11, Limit Up-Limit Down Plan and Trading Pauses in Individual Securities Due to Extraordinary Market Volatility

April 25, 2019.

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (the ''Act'')[2] and Rule 19b–4 thereunder,[3] notice is hereby given that on April 19, 2019, NYSE National, Inc. (''NYSE National'' or the ''Exchange'') filed with the Securities and Exchange Commission (the ''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit

[150] 17 CFR 200.30–3(a)(12).

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

[2] 15 U.S.C. 78a.

[3] 17 CFR 240.19b–4.