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February 10, 2014

Submitted via rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number SR-FINRA-2014-003

Ladies and Gentlemen:

This letter is submitted in response to the request for comments published by the Securities and Exchange Commission (the "SEC") in SEC Release No. 34-71372 (January 23, 2014),[1] with respect to proposed amendments to FINRA Rule 5110 (the "Corporate Financing Rule" or "Rule 5110") and FINRA Rule 5121 (the "Conflicts of Interest Rule" or "Rule 5121") (the "Proposal"). The Proposal would amend:

1. The definition of "participation or participating in a public offering" in Rule 5110(a)(5) (the "participation" definition) to exclude FINRA members that solely provide services to the issuer as an "independent financial adviser," as defined in the Proposal (the "Adviser Proposal" or "independent financial adviser" exemption).
2. The information filing requirements in Rule 5110(b)(6)(A)(iii) to limit the requirement to submit a statement of the association or affiliation of officers, directors, greater-than-5% shareholders, and any acquirer of the issuer's securities within 180 days prior to the filing of the offering (the "180-day review period") with "any member" to only apply to participating FINRA members.
3. The lock-up restrictions in Rule 5110(g)(1) to exempt any securities acquired in compliance with the exception from underwriting compensation under Rule 5110(d)(5)(D).
4. Rule 5121(f)(6) to eliminate beneficial ownership of subordinated debt as a basis for a "conflict of interest".

I. Introduction and Summary

The general purpose of the Proposal, as stated by FINRA in the Proposing Release, is "to simplify and refine the scope of the rules."[2] This is a laudable objective, as it is in the interest of the securities industry, issuers and investors that the FINRA rules be reviewed from time-to-time to reconsider whether

[1] SEC Release No. 34-71372 (January 23, 2014); 79 FR 4793 (January 29, 2014) (the "Proposing Release").

[2] Proposing Release, at 4793.

the rules continue to carry out their intended purposes without unnecessary burdens on the securities industry or on capital-raising by issuers, while continuing to protect issuers and investors.

I support the amendments to Rules 5110 and 5121, other than the Adviser Proposal, because they more properly focus the operation of the Corporate Financing Rule and the Conflicts of Interest Rule without impacting issuer or investor protections. In the case of the Adviser Proposal, I recognize the benefits of FINRA's conclusion that it is in the interest of issuers seeking to obtain independent advice from a FINRA member that the compensation of an "independent financial adviser" be exempted from the calculation of underwriting compensation for the offering in order to avoid any unintended negative impact of the Corporate Financing Rule on an issuer's ability to obtain such independent advice. However, the scope of the exemption goes far beyond the compensation limitations of the Corporate Financing Rule as it would exempt the consulting arrangements with a FINRA member from all issuer and investor protection provisions of FINRA Rules 5110, 5121 and 2310. Moreover, the proposed exemption is not limited to large-sized companies with the negotiating power to avoid problematic consulting arrangements with an "independent financial adviser" or to FINRA members with a history of participating in underwritings or providing advice on capital-raising alternatives to companies.

Therefore, I have recommended that the Adviser Proposal be revised to include additional conditions requiring compliance by an "independent financial adviser" with the Corporate Financing Rule's requirements for: (1) the filing of information; (2) prospectus disclosure; (3) restrictions on the terms of any option, warrant or convertible security acquired during the 180-day review period; and (4) a 180-day post-offering lock-up in the case of any securities acquired during the 180-day review period. I believe that these conditions would support certain public interest purposes of the Corporate Financing Rule, discussed below, while not impeding the ability of an issuer to engage an "independent financial consultant" or the willingness of a FINRA member to provide such services, as intended by FINRA.

Set forth below are my detailed comments on the four proposed amendments.

II. Amendment to the Definition of "Participation or Participating in a Public Offering"

A. The Adviser Proposal

"Participation" is defined in Rule 5110(a)(5) as "Participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, furnishing of customer and/or broker lists for solicitation, or participating in an advisory or consulting capacity to the issuer related to the offering but not the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEA Rule 13e-3." FINRA is proposing to amend the definition of "participation" to exempt a FINRA member that is an "independent financial adviser" to the issuer, which term is proposed to be defined as "a member that provides advisory or consulting services to the issuer and is neither engaged in, nor affiliated with any entity that is engaged in, the solicitation or distribution of the offering."

FINRA states in the Proposing Release that the purpose of the Adviser Proposal is to permit an issuer to be "free to seek the benefit of consulting services from a member that is not engaged in the distribution or sale of its securities regarding such matters as the options for financing that may be available to the issuer, the benefits and disadvantages of a public offering and the terms proposed by the underwriters." [3]

[3] Proposing Release, at 4794.

B. Comments on the Scope of the Adviser Proposal Exemption

An "underwriter and related person," as defined in Rule 5110(a)(6), includes "participating members," as well as underwriter's counsel, financial consultants and advisors and finders, and related persons to a participating member. The structure of the Adviser Proposal as an exception from the definition of "participation" would, therefore, exclude FINRA members that provide consulting services as an "independent financial adviser" from the pivotal definition of "underwriter and related persons." [4]

Although the Proposing Release discusses that the compensation of the "independent financial advisor" would be excluded from the calculation of underwriting compensation, the Proposing Release does not specifically reference the other provisions of Rules 5110, 5121 and 2310 that would no longer apply to the consultant and the consulting arrangement because an "independent financial adviser" would not be within the "underwriter and related persons" definition.

This is to request that FINRA clarify that the exemption would operate to exclude an "independent financial adviser" from compliance with all provisions of the Corporate Financing Rule, Rule 5121, and Rule 2310, including provisions that require that:

(1) a member that anticipates participating in a public offering must file with FINRA the documents and information with respect to the offering (Rule 5110(b)(4)(A));

(2) information on the consulting agreement, securities acquired from the issuer by the underwriter and related persons within the 180-day review period, and any conflict of interest with the issuer must be disclosed to FINRA (Rule 5110(b)(6)(A)(ii));

(3) the value of any cash compensation, reimbursed expenses, securities and any right of first refusal ("ROFR") must be included in the calculation of underwriting compensation for the offering and the total compensation for the offering must comply with the FINRA non-public underwriting compensation guidelines or the 10% compensation limitation in Rule 2310 (Rules 5110(c)(2)(D) and (d)(1) and Rules 2310(b)(4)(B)(ii) and (b)(4)(E));

(4) the consulting arrangement and the value of all compensation and any other acquired securities acquired within the 180-day review period must be disclosed in the Plan of Distribution under Rule 5110(c)(2)(C) and Item 508 of SEC Regulation S-K and any conflict of interest between the "independent financial adviser" and the issuer must be disclosed under Rule 5121(a)(1);

(5) any securities of the issuer acquired by the underwriter and related persons must be subject to a lock-up of 180 days from the effective date of the public offering (Rule 5110(g));

(6) the type of securities received by the underwriter and related persons must be able to be valued, *i.e.*, either be the same as the offered securities or have a public market, under Rule 5110(f)(2)(I);

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[4] In comparison, if fees in the form of cash or securities or another type (*e.g.*, a right of first refusal) received by an "independent financial adviser" pursuant to a consulting agreement were structured as an exception from being an "item of value" by amendment to Rule 5110(c)(3)(B), the FINRA member-consultant would remain a "participating member" and an "underwriter and related person" that is subject to all other provisions of the Corporate Financing Rule.

(7) if the securities received by the underwriter and related persons within the 180-day review period are in the form of a warrant, option or other convertible security, the terms of the security must comply with Rule 5110(f)(2)(H), which provision, among other things, limits the exercise or conversion of the security to no more than five years from the effective date of the offering, limits demand registration rights to one time at the issuer's expense, and limits the anti-dilution[5] terms of the security; and

(8) the terms of any ROFR must comply with Rule 5110(f)(2)(F) and (G).

C. Comments on the Purpose of the Definition of "Participation"

FINRA expresses the view that the Corporate Financing Rule should apply only to those FINRA members that are ". . . in a position to extract unreasonable underwriting terms, arrangements or compensation from issuers."[6] FINRA explains that, unlike a FINRA member that "is involved in distribution and solicitation activities, a member that solely provides advisory or consulting services typically would not have a significant degree of leverage over an issuer. Consequently, FINRA does not believe that the harms sought to be prevented by Rule 5110 are likely to occur in such cases." [7]

I agree with FINRA that a FINRA member-consultant is in a less powerful position in comparison to the underwriters to negotiate an unfair arrangement with an issuer. However, I believe that the ability of a consultant or an underwriter to exercise a "significant degree of leverage over the issuer" also, and perhaps primarily, depends upon the comparative negotiating power of the issuer. Moreover, the comparative negotiating power of a FINRA member-consultant to the issuer is immaterial when the issuer's representative does not view an arrangement that departs from the special requirements of the Corporate Financing Rule to be inappropriate for the company or contrary to normal business practices.

FINRA's belief that an "independent financial adviser" is not likely "to extract unreasonable underwriting terms, arrangements or compensation from issuers"[8] may reflect the staff's recent experience that those companies that are hiring FINRA members to provide independent advice on a potential IPO are major companies with significant negotiating power to fend for themselves and avoid arrangements considered to be unfair and unreasonable under the Corporate Financing Rule. Such companies likely conduct large-sized initial public offerings ("IPOs") from the high hundred millions to in excess of $1 billion. However, the Adviser Proposal is not limited to such companies. In the case of medium and small-sized companies, the company may not have sufficient power to be dominant in negotiating arrangements with a consultant.

Therefore, I am recommending that the Adviser Proposal be revised to continue to apply certain primary provisions of the Corporate Financing Rule to an "independent financial adviser" in order to

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[5] "Disproportionate" anti-dilution terms are terms of an exercisable or convertible security that do not also benefit the issuer's other shareholders, unlike a stock-split or stock dividend where the consultant is treated like other shareholders and merely retains its proportional ownership in the issuer's securities.

[6] Proposing Release, at 4794.

[7] *Id*.

[8] *Id*.

carry out important public interest purposes of the Corporate Financing Rule, while retaining FINRA's purpose to facilitate the ability of an issuer to obtain pre-IPO advice from a FINRA member that is independent of the underwriters.

D. **Recommended Changes to the Adviser Proposal In Furtherance of Other Purposes of the Corporate Financing Rule**

Information Filing Requirements: Because an "independent financial adviser" would be excluded from the definition of "participation," (among other things) information on the consulting agreement, any acquisitions of securities by the "independent financial adviser" within the 180-day review period, and any conflict of interest between the consultant and the issuer would not be required to be filed with FINRA by the underwriter under Rule 5110(b)(6).

I believe that it would be in the public interest for FINRA to continue to monitor whether the consulting and other arrangements of a FINRA member relying on the "independent financial adviser" exemption presents any regulatory issues and, if such issues should develop, to take any required steps (including revising its rules) to address any problematic situations. I also believe that information regarding any conflict of interest, the consulting arrangement, and any security acquisitions should be disclosed to investors in the public offering, which is discussed separately below.

Therefore, I recommend that the Adviser Proposal be revised to include a condition requiring that an "independent financial consultant" comply with the information filing requirements in Rule 5110((b)(6) or that the exemption specifically require that information on the consultant's affiliation with the issuer, acquisition of securities and the consulting agreement be filed with FINRA. I do not believe that the filing of such information would impose any burden on the issuer's ability to engage an "independent financial adviser."

I also recommend that FINRA clarify whether it would exercise its historical authority under Rule 5110 to conclude that a consulting arrangement with an "independent financial adviser" is unfair and unreasonable, despite the availability of the exemption, in the limited circumstance where FINRA staff determine that the consulting arrangement does not conform to "high standards of commercial honor and just and equitable principles of trade" under FINRA Rule 2010.

The Disclosure Requirements of Rules 5110 and 5121: Item 508 of SEC Regulation S-K and FINRA Rule 5110(c)(2)(C) require disclosure in the prospectus of all items of underwriting compensation as determined by FINRA in order that potential investors are aware of the details and total amount of such compensation and also can compare underwriting compensation between offerings. In addition, FINRA Rule 5121(a)(1) requires disclosure in the prospectus of any conflict of interest between a participating member and the issuer.

The Adviser Proposal would exclude an "independent financial adviser" from the prospectus disclosure requirements of the foregoing provisions. Therefore, unless otherwise disclosed by the issuer or required to be disclosed by other SEC rules, potential investors will not be aware that an offering, for example, with a 6.5% discount also includes "independent financial adviser" consulting fees of .50% in cash and 1.20% in securities, in comparison to an offering in which the issuer is solely paying a 6.5% discount.

I believe that potential investors should be provided information regarding the "independent financial adviser's" consulting arrangement, acquisitions of securities and any conflict of interest, even

though such arrangement is not included in the calculation of underwriting compensation nor required to be disclosed by SEC rules as a material contract. Therefore, I recommend that the Adviser Proposal be amended to include a condition requiring that a separate paragraph in the "Plan of Distribution" section of the prospectus disclose:

(1) the identity of the consultant;

(2) an explanation of the consulting arrangement, including the form (cash and securities or other arrangement) and amount of any compensation, and any terms providing for liquidated damages or a right of first refusal;

(3) the acquisition of any securities of the issuer by the consultant during the 180-day review period in addition to those disclosed under (2) above; and

(4) any "conflict of interest" with the issuer as defined in Rule 5121(f)(5).

The prior recommendation that the consulting agreement and information be filed with FINRA will permit FINRA staff to review the disclosure. I do not believe that prospectus disclosure of such information would inhibit the issuer's ability to engage an "independent financial consultant" because such prospectus disclosure should not dissuade a FINRA member from providing such consulting services.

Regulation of Securities: The Corporate Financing Rule has reflected a special concern about the receipt or acquisition of an issuer's securities by the "underwriter and related persons" close to the time of the offering as a result of the person's relationship to the issuer's preparation for and conduct of the public offering. Such concerns relate to the advantageous discounted purchase price that may be obtained from the issuer's private placement within 180 days prior to the filing of the offering by FINRA members knowledgeable about a potential IPO, the terms of any warrants or options that may be unfair to the issuer and its post-offering shareholders as described in Section II.B. above, and the ability of the acquirer to sell securities acquired within the 180-day review period immediately into the aftermarket of the IPO when the market price generally reflects a premium. In particular, the 180-day lock-up restriction imposed by Rule 5110(g) was intended to impose an investor's risk on the "underwriter and related persons" with respect to such securities and allow the IPO aftermarket to develop prior to sales by such person.

Any securities acquired by an "independent financial adviser" as a fee for consulting services or by purchase from a private placement during the 180-day review period would be exempt from these provisions regulating securities acquisitions. Therefore, I recommend that the Adviser Proposal be amended to include a condition requiring that an "independent financial consultant" comply with the 180-day lock-up restriction in Rule 5110(g) with respect to any securities of the issuer acquired pursuant to the consulting agreement or otherwise during the 180-day review period. Since a 180-day lock-up is also commonly imposed by the underwriter on the officers, directors and major shareholders of the issuer in the case of an IPO, imposing the Corporate Financing Rule 180-day lock-up requirement should not inhibit the willingness of a FINRA member to provide consulting services to an issuer as an "independent financial adviser."

I also recommend that FINRA require that any option, warrant or convertible security acquired by the "independent financial adviser" during the 180-day review period comply with the restrictions Rule 5110(f)(2)(H) (with the exception of sub-provision (ii)) on the terms of such securities, as described above in Section II.B. It should not be a burden on the issuer's ability to engage an "independent financial adviser" to require that the consultant comply with these requirements in order to address the potential negative impact of such arrangements on the company and its shareholders.

E. Comments on Possible Difficulties of Compliance With the Adviser Proposal

Distinguishing Permissible Consulting Services from Services That Require Application of Rule 5110: The text of the Adviser Proposal amendment does not restrict the "independent financial adviser" to the activities enumerated by FINRA in the discussion of the Adviser Proposal in the Proposing Release; only prohibiting the "independent financial adviser" from being neither engaged in, nor affiliated with any entity that is engaged in, the solicitation or distribution of the offering.

I am concerned that the ordinary advisory services enumerated by FINRA and any other services by an "independent financial consultant" may be difficult to distinguish from and may merge into those activities that would bring such a consultant within the definitions of "underwriter and related persons" and "participation." The definition of "underwriter and related persons" includes finders (discussed further separately below) and the definition of "participation" includes a FINRA member that provides a list of potential customers or broker/dealer participants to the issuer or participates in any preparation of the offering or other documents. This is particularly the case as the exact boundaries of the activities covered by the definition of "participation" and "underwriter and related persons" are, at times, unclear. For example, would providing comments on the draft registration statement constitute participating in the preparation of the document, thereby eliminating the "independent financial adviser" exception?

This is to request that FINRA assist FINRA members to comply with the Adviser Proposal exemption by enumerating permissible consulting activities for an "independent financial adviser" and providing (where possible) guidance with respect to types activities that the consultant should not engage in (which is further discussed in the next section).

Scope of the Prohibition on "Solicitation or Distribution of the Offering" and Being a Finder: In particular, I am concerned that such a consultant, in the course of providing advice on the options for financing and the terms proposed by underwriters among other possible activities requested by an issuer, would be considered to be engaged in the "solicitation or distribution of the offering", as prohibited by the Adviser Proposal, or to be a "finder" under the definition of "underwriter and related persons" by assisting an issuer in identifying potential FINRA members or registered investment advisers as distribution channels and even contacting and arranging introductions to such persons.

However, securities firms may view the prohibition in the Adviser Proposal on solicitation and distribution activities more narrowly to only apply to the solicitation of sales or distribution of the offering securities to the ultimate customer and not to the solicitation of or distribution to potential intermediaries.[9] Further, although the "finder" category in the definition of "underwriter and related person" and the category of "furnishing of customer and/or broker lists for solicitation" in the definition of "participation" cover introductions to or lists of FINRA members, they do not cover the same activities with non-member intermediaries, such as registered investment advisers (which also may not be viewed as being a "customer").

Therefore, this is to request that FINRA clarify the scope of the prohibition on "solicitation or

[9] *See*, NASD Notice to Members 85-29 (April, 1985) expressing concern about wholesaling activities within both the sponsor and general partner of a direct participation program subject to compliance with what is now FINRA Rule 2310, *i.e.*, activities to "find" broker/dealers to act as Selected Dealers for the offering. Although the Notice focused on wholesaling activities by employees, as that was the problematic practice at the time, FINRA's concerns regarding such activities should nonetheless also apply to any consultant hired by an issuer to provide similar services.

distribution of the offering" and of acting as a finder to assist FINRA members to comply with the exemption provided by the Adviser Proposal.

III. Comments on the Proposal to Amend the Information Filing Requirements

A. The Proposal

FINRA is proposing to amend the information filing requirements in Rule 5110(b)(6)(A)(iii) to revise the requirement to submit a statement of the association or affiliation of officers, directors, greater-than-5% shareholders, and any acquirer of the issuer's securities within the prior 180 days with "any member" (even though not participating in the offering) to only require such information with respect to a participating FINRA member. Since an "independent financial adviser" would not be treated as a participating FINRA member under the Adviser Proposal, such information would not be required to be submitted regarding the "independent financial adviser."

B. Comments

To the extent that FINRA adopts the Adviser Proposal without adding the condition recommended above that would continue to require the filing of information relevant to the "independent financial adviser," I am opposed to this amendment. If FINRA does not receive the required information with respect to a FINRA member that claims to be an "independent financial adviser," it is possible that the SEC may also not be aware of this information, because the consulting arrangement is likely to be considered to be a minor contract not required to be disclosed in the registration statement or filed as an exhibit thereto.

If, however, FINRA adopts some form of the recommended condition to the Adviser Proposal, I support the narrowing of the information filing requirement as proposed, as no investor protection concerns are presented by limiting the information filed to those FINRA members that are participating in the public offering in any capacity.

IV. Comments on the Proposal to Amend the Lock-Up Restriction

A. The Proposal

FINRA would also amend the lock-up restriction in Rule 5110(g)(1) to exempt any securities acquired by an underwriter and related person during the 180-day review period in compliance with the exception from underwriting compensation under Rule 5110(d)(5)(D) in the case of securities received as a result of: (1) a right of preemption related to securities that were not deemed by FINRA to be underwriting compensation, or purchased from a public offering or the public market; (2) a stock-split, pro-rata rights or similar offering where the original securities were acquired more than 180 days preceding the filing of a registration statement; and (3) the conversion of securities that were not deemed by FINRA to be underwriting compensation.

B. Comments

I support FINRA's proposals to amend the lock-up restriction in Rule 5110(g) to exempt any securities acquired by underwriter and related persons as a result of a transaction that complies with the exception provided by Rule 5110(d)(5)(D), as the acquisition during the 180-day review period is the result of a prior acquisition of securities that were purchased from a public offering or the public market

or were not deemed to be underwriting compensation by FINRA or because the acquisition is the result of the issuer's stock-split, pro-rata rights or similar offering. The purpose of the lock-up restriction was meant to impose an investor's risk on an underwriter and related person only with respect to securities purchased or received close to the time of the anticipated public offering and was not meant to penalize shareholders who acquire additional securities of the issuer during the 180-day review period as a result of a prior acquisition for which the person has already experienced an investor's risk.

V. Comments on the Proposal to Amend the Conflicts of Interest Rule

A. Proposal

FINRA is proposing to amend Rule 5121(f)(6) to eliminate beneficial ownership of subordinated debt as a basis for determining that a "conflict of interest" exists between a participating FINRA member and the issuer, which requires compliance with that rule.

B. Comments

I support FINRA's proposal to amend Rule 5121(f)(6). Historically, the ownership of debt has not been the basis for a determination of control by one party with respect to a business entity. Rather, control has been founded upon the ownership of equity and equity-like securities or interests and management control.

VI. Conclusion

I urge FINRA to reconsider the Adviser Proposal and to adopt the recommended conditions to the availability of the "independent financial adviser" exception to the definition of "participation" in light of the comments provided herein. The three other proposed rule changes should be adopted in order to more effectively focus the protections and requirements of Rules 5110 and 5121.

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I appreciate the opportunity to submit these comments.

Very truly yours,

Suzanne Rothwell
Managing Member

CC: Raquel Russell
Associate General Counsel
FINRA, Office of the General Counsel

Paul Mathews
Vice President and Director
FINRA, Corporate Financing Department