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Via e-mail: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Attention: Elizabeth M. Murphy, Secretary

Re: SR-FINRA-2010-026; Release No. 34-62199
NASD Rule 2720 Renumbered as FINRA Rule 5121

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee" or "we") of the Section of Business Law (the "Section") of the American Bar Association (the "ABA") in response to the request by the Securities and Exchange Commission (the "Commission" or "SEC") for comments with respect to the proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA") to incorporate NASD Rule 2720 into the consolidated FINRA rulebook as FINRA Rule 5121 (the "Rule"), as set forth in the release referenced above. This letter was prepared by members of the Committee's FINRA Corporate Financing Rules Subcommittee with input from other members of the Committee.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

The proposing release referred to above states that FINRA is proposing to incorporate NASD Rule 2720 into the consolidated FINRA rulebook without material change. Although we have no objection to the consolidation, there are several amendments and clarifications that we recommend be adopted, for the benefit of both FINRA, in facilitating its review of offerings subject to the Rule, and FINRA members, in

seeking to comply with the Rule. These proposals reflect the experience with NASD Rule 2720 since it was significantly amended in 2009 (the "2009 Amendments").[1]

I. Clarification of "Participation in a Public Offering"

NASD Rule 2720(a) states that "No member that has a conflict of interest may participate in a public offering unless the offering complies" with the Rule. The definition of "participation or participating in a public offering" in FINRA Rule 5110(a)(5)[2] reaches a much broader group of activities than those that were covered by NASD Rule 2720 prior to the 2009 Amendments. In FINRA Regulatory Notice 09-49 (August 2009) (the "Notice"), FINRA clarified that the "new rule continues to apply specifically to a member firm's participation in the distribution of a public offering as an underwriter, member of the underwriting syndicate or selling group, or otherwise assisting in the distribution of the public offering (*i.e.*, not when a member firm acts solely as a finder, consultant or adviser, given these capacities generally do not involve managing or distributing a public offering."

In order to avoid confusion as to the scope of the post-consolidation Rule, we recommend that FINRA reflect this clarification either in the form of supplementary material following the Rule or by amending subsection (a) as follows (new text is underlined and deleted text is in brackets):

> "No member that has a conflict of interest may <u>underwrite,</u> participate <u>as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of</u> [in] a public offering unless the offering complies with" the Rule.

II. Clarification of Which Members are Considered "Primarily Responsible for Managing the Public Offering"

Pursuant to current NASD Rule 2720(a)(1)(A), an exemption from the qualified independent underwriter ("QIU") and filing requirements is available in respect of a public offering in which "the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the [disciplinary history requirements for a QIU]...." The Notice states that ". . . in cases where two or more book-running lead managers have equal responsibilities with

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[1] SEC Release No. 34-60113 (June 15, 2009); 74 F.R. 29255 (June 19, 2009). FINRA had sought comments to such amendments through SEC Release No. 34-59880 (May 7, 2009); 74 F.R. 22600 (May 13, 2009) (the "2009 Proposing Release").

[2] "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 participation in any 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 SEC Rule 13e-3."

regard to due diligence, each must be free of conflicts of interest…." We believe that it is clear from the text of the Rule and from the Notice that FINRA intended to differentiate between co-lead managers for the purposes of the aforesaid exemption on the basis of whether or not a co-lead manager has book-running responsibility in respect of the offering; *i.e.*, that it is the co-lead manager(s) with book-running responsibilities that are "primarily responsible for managing the public offering."

We further believe that the focus on this exemption, by its terms, is not on the co-lead manager's conduct of, or participation in, due diligence as might also be suggested by the Notice, because a co-lead manager's exercise of its due diligence responsibilities is not relevant to whether the firm has assumed primary responsibility for managing the offering.

Therefore, we recommend that FINRA amend the text of FINRA Rule 5121(a)(1)(A) to clarify that book-running responsibility is the sole criterion of primary management responsibility for a public offering in the case of more than one lead manager for the purposes of this exemption, in order to avoid inadvertent non-compliance with the exemption, as follows (new text is underlined and deleted text is in brackets):

> "(A) the member(s) [primarily responsible for managing] <u>serving as the sole manager or a book-running manager of</u> the public offering, does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(12)(E);"

III. Comments on Definitions

A. Definition of "Qualified Independent Underwriter"- An Alternative Experience Standard

NASD Rule 2720(f)(12) sets forth the qualification requirements for a "qualified independent underwriter." In order for a FINRA member to serve as QIU, the member, among other things, must have served as an underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering for which there is no registration statement. With respect to a public offering of equity securities, this requirement is satisfied if the member has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (including convertible securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering. The Rule has reflected the 50% standard for many years. FINRA requested comment in the 2009 Proposing Release as to whether the 50% threshold should be lowered if an equity offering is particularly large and provided the example of a $1 billion offering.

When the predecessor to NASD Rule 2720 was adopted in 1972, offerings were generally of a much smaller size than they are today. In recent years, offerings in excess of $1 billion are not unusual, and in some cases the offerings exceed $10 billion. In recent situations involving multi-billion dollar offerings, there has been some difficulty in qualifying the most experienced

FINRA member as a QIU under the 50% standard, because such offerings do not occur with such frequency that a single FINRA member will necessarily have participated in three offerings of several billion dollars in a three-year period. Based on discussion with industry members, we understand that the level of experience and detail involved in a due diligence investigation that should be required of a QIU for an offering in excess of $1 billion are comparable to those involving offerings that are at least $100 million. Offerings of this size are generally underwritten by large, experienced and highly-qualified members. In fact, such members generally only underwrite equity offerings of at least this size category and this same group of members is also generally responsible for offerings in excess of $1 billion. There appears, we understand, to be no consistent distinction in the quality of due diligence for offerings in excess of $100 million. However, in the case of offerings in the $300 million or greater range, we understand that a managing underwriter may acquire greater experience in the more complex sales and distribution compliance issues that could arise as a result of the larger amount of securities being distributed, including issues arising in connection with multi-national offerings.

In order to ensure that the QIU for an equity offering of $1 billion or more has the requisite experience to conduct due diligence for an offering of that size, we recommend that the definition of QIU in renumbered FINRA Rule 5121(f)(12) be amended to permit a FINRA member to qualify as a QIU with respect to an equity offering of $1 billion or more if the member has served as an underwriter of at least three equity public offerings, which each generated gross proceeds of at least $500 million, as follows (new text is underlined):

> (ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of <u>the lesser of $500 million or</u> not less than 50% of the anticipated gross proceeds of the proposed offering.

For offerings above $500 million, it is our understanding that virtually all managing underwriters have a sophisticated understanding of both their due diligence obligations and complex distribution matters.

B. Definition of "Affiliate"

The 2009 Amendments significantly revised the definition of "affiliate" by including a new definition of "control" that expands the concept of "affiliation" to the beneficial ownership of 10% or more of the outstanding non-voting common equity, subordinated debt or preferred equity of an entity. These indicia of a "control" relationship were previously covered by the definition of a "conflict of interest" in prior NASD Rule 2720(b)(7).

The introduction to NASD Rule 2720(f), which contains the definitions, states that the definitions are "For purposes of this Rule. . . ." However, FINRA Rule 5110 specifically incorporates the definitions in NASD Rule 2720. We believe that FINRA staff generally rely on the definition of "affiliate" in NASD Rule 2720 for purposes of interpretation of other FINRA

rules, unless the rule being reviewed includes its own definition of the term. We are concerned that the revised definition of "control" in current NASD Rule 2720 will be inappropriately expanded beyond its intended scope to apply to a broad range of matters for which its application would create confusion and in some cases be inconsistent with the policies underlying the matter, where the term "affiliate" is intended to have its more traditional meaning, *i.e.*, affiliation based on ownership of at least 10% of voting securities or management control. In the current version of NASD Rule 2720, the term affiliate is used in:

- (f)(5)(C)(i) and (ii), relating to proceeds to "a member, its affiliates and its associated persons;" and
- (f)(12)(A), in the definition of "qualified independent underwriter" relating to affiliates of the qualified independent underwriter.

In FINRA Rule 5110, the term "affiliate" is used, among other places, in the definition of "issuer" (which includes an affiliate of the issuer as well as a selling security holder) and "participating member" (which includes any affiliate of the member). In these contexts, we do not believe that FINRA intended that the term "affiliate" be defined to include relationships that are based on ownership of 10% or more of the outstanding non-voting common equity, subordinated debt or preferred equity of an entity based upon the definition of "control" in NASD Rule 2720.

We therefore suggest that the definition of "affiliate" in NASD Rule 2720 be limited to use in NASD Rule 2720 and solely with respect to the determination of the affiliate relationship between the issuer and a member participating in the offering by amending the definition of "affiliate" as follows (new text is underlined):

> "The term 'affiliate' means, solely for purposes of this rule, an entity that controls, is control by or is under common control with a member."

C. Definition of "Entity"

The definition of "entity" in NASD Rule 2720(f)(7)(B) sets forth certain exceptions that are the same as the exceptions from the definitions of "affiliate" and "conflict of interest" that existed in the prior version of NASD Rule 2720, except with respect to the exception that previously existed for "a corporation, trust, partnership or other entity issuing financing instrument-backed securities which are rated by a national recognized statistical rating organization in one of its four highest generic rating categories" ("FIBS"). Presumably, FINRA chose not include the latter as an exception in NASD Rule 2720 on the ground that NASD Rule 2720 contains adequate "relief" through the exemption from the QIU and filing requirements for an offering of investment grade rated securities (see NASD Rule 2720(a)(1)(C)).

Under the current rule, however, although neither a filing nor a QIU is required, public offerings of FIBS are now subject to the requirement to prominently disclose the conflict of interest and the prohibition on sales to discretionary accounts, even though such offerings were

entirely exempt from such requirements under the prior Rule. We do not think that this result was intended and, therefore recommend that the definition of "entity" in NASD Rule 2720(f)(7)(B) be revised to specifically exempt FIBS, as set forth above.

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The Committee appreciates the opportunity to comment on the Proposing Release. Members of the Committee are available to discuss our comments should the Commission or the staff so desire.

Very truly yours,

/s/ Jeffrey W. Rubin

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