FINRA
Financial Industry Regulatory Authority

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

Re: File No. SR-FINRA-2010-026 – Response to Comments

Dear Ms. Murphy:

This letter responds to comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing, a proposed rule change to adopt NASD Rule 2720 (Public Offerings of Securities With Conflicts of Interest) as a FINRA rule in the Consolidated FINRA Rulebook without material change. The proposed rule change would renumber NASD Rule 2720 as FINRA Rule 5121 in the consolidated FINRA rulebook. The Commission received one comment letter in response to the proposal.[1]

NASD Rule 2720 governs public offerings of securities in which a member with a conflict of interest participates. The Rule generally prohibits a member with a "conflict of interest," as defined in the Rule, from participating in a public offering, unless certain requirements are met.[2]

While the ABA notes that it has no objection to the consolidation of NASD Rule 2720 as a FINRA rule, it recommends that FINRA make several amendments and clarifications to the Rule, based on its "experience with NASD Rule 2720 since it was

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1 Letter from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, American Bar Association, Business Law Section, to Elizabeth M. Murphy, Secretary, SEC, dated June 22, 2010 ("ABA").

2 The rule requires prominent disclosure of the nature of the conflict, and in certain circumstances, the participation of a qualified independent underwriter. Members also must comply with certain net capital, discretionary accounts and filing requirements, as applicable.

significantly amended in 2009."[3] The ABA's comments go beyond the scope of the proposed rule change, which is to renumber an existing NASD rule as a FINRA rule, without material change. Nevertheless, FINRA's response to each of the suggested amendments and clarifications is discussed below.

Definition of "Participation or Participating in a Public Offering"

The ABA suggests that FINRA modify the application of the Rule from the existing standard in which a member "participates" in a public offering to one in which a member must "underwrite, participate as a member of the underwriting syndicate or selling group, or otherwise assist in the distribution of" a public offering. The ABA's comment is addressed in Regulatory Notice 09-49. In the Notice, FINRA stated: ". . . the new [R]ule 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)." FINRA believes that the term "participation" is widely understood and that defining it as suggested by the ABA would be an inappropriate narrowing of the Rule.

Definition of a Member "Primarily Responsible for Managing the Public Offering"

NASD Rule 2720(a)(1)(A) (proposed FINRA Rule 5121(a)(1)(A)) provides an exemption from the qualified independent underwriter ("QIU") and filing requirements in certain cases if "the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(12)(E)." Regulatory Notice 09-49 further provides that, in cases where two or more book-running lead managers have equal responsibilities with regard to due diligence, each must be free of conflicts of interest. The ABA suggests that FINRA replace the language "primarily responsible for managing" a public offering to refer to a member "serving as the sole manager or a book-running manager" of the public offering based on its belief that the sole criterion of primary management responsibility for a public offering should be book-running responsibility. FINRA believes that the ABA's suggestion would inappropriately narrow the application of the Rule. Book-running responsibility may be an indication that a member is "primarily" responsible for managing a public offering,

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3 As a general matter, FINRA rules are subject to notice and comment and approval by the SEC. FINRA notes that NASD Rule 2720 became effective in September 2009 following the prescribed comment period and SEC approval. See Regulatory Notice 09-49 (SEC Approves Amendments to Modernize and Simplify NASD Rule 2720 Relating to Public Offerings in Which a Member Firm With a Conflict of Interest Participates) (August 2009).

but it should not be the only criterion. FINRA believes that the Rule, as currently drafted, allows it to keep at pace with evolutions in the underwriting process, while acknowledging some of the varied roles members play in best efforts and other types of offerings.

Definition of QIU

NASD Rule 2720(f)(12) (proposed FINRA Rule 5121(f)(12)) requires a QIU for a proposed public offering of equity securities to have acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering. The ABA believes that this standard may be difficult for members to meet in very large offerings (e.g., offerings in excess of $1 billion). The ABA consequently suggests adding an alternative standard to paragraph (f)(12) that would permit a 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.

FINRA recognizes the heightened QIU qualification standards for very large offerings due to the 50% threshold of the existing rule. However, the proposal offered by the ABA is just one of several alternatives that may be used to address this issue and FINRA intends to take a more comprehensive review of this matter before proposing any changes to the Rule. FINRA continues to have exemptive authority under paragraph (e) of the Rule to address those rare circumstances in which the 50% threshold may unnecessarily limit the availability of a QIU.

Definition of Affiliate

The ABA suggests adding language to the definition of "affiliate" in current paragraph 2720(f) (proposed FINRA Rule 5121(f)) that indicates that the meaning is "solely for the purposes of" Rule 2720. The ABA is concerned that the new definition of "affiliate" in this Rule might have unintended consequences to its application in other FINRA rules. FINRA does not agree with the change proposed by the ABA and we note further that the thrust of this comment concerns rules other than those that are the subject of this proposed rule change. To the extent that that any member believes that the application of an existing FINRA rule is inconsistent with the provisions of such rule, there are established processes to address such matters.

Definition of Entity

The ABA's final suggestion is to exempt from the definition of "entity" in paragraph 2720(f)(7)(B) (proposed FINRA Rule 5121(f)(7)(B)) "FIBS," or entities that issue financing instrument-backed securities which are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories. The

ABA notes that the current rule neither requires a filing or a QIU in offering of FIBS, but requires members to prominently disclose their conflicts of interests and prohibits sales to discretionary accounts. The ABA suggests that FINRA's application of the Rule to FIBS was not intended. FINRA disagrees. In Regulatory Notice 09-49, FINRA noted that the Rule applied to FIBS and therefore, the Rule works exactly as FINRA intended.[4]

FINRA believes that the foregoing responds to the issues raised by the ABA to this rule filing. If you have any questions, please contact Gary Goldsholle, Vice President and Associate General Counsel, at (202) 728-8104; or me at (202) 728-8056.

Very truly yours,

Stan Macel

Stan Macel
Assistant General Counsel

cc: Joseph Price, Senior Vice President and Counsel, Corporate Financing
Paul Mathews, Director, Corporate Financing

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[4] Regulatory Notice 09-49 states:

"FINRA also notes that the exclusions in the term 'entity' are substantially similar to the exemptions from the conflict of interest provisions contained in previous Rule 2720, with the exception of an entity that issues financing instrument-backed securities, which is now subject to the rule." (Emphasis added.)