Financial Industry Regulatory Authority

April 16, 2014

Kevin O'Neill
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2014-003 (Proposed Rule Change to Amend FINRA's Corporate Financing Rules to Simplify and Refine the Scope of the Rules) – Response to Comments

Dear Mr. O'Neill:

This letter is being submitted by Financial Industry Regulatory Authority, Inc. ("FINRA") in response to comments submitted to the U.S. Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing ("Proposal").[1]

FINRA proposes to amend FINRA's corporate financing rules to simplify and refine their scope. Specifically, FINRA proposes to amend Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements) to: (1) narrow the scope of the definition of "participation or participating in a public offering"; (2) modify the lock-up restrictions to exclude certain securities acquired or converted to prevent dilution; and (3) clarify that the information requirements apply only to relationships with a "participating" member. FINRA also proposes amendments to Rule 5121 (Public Offerings of Securities with Conflicts of Interest) to narrow the scope of the definition of "control."

Comments

The Commission received two comment letters in response to the Proposal.[2] In its comment letter, SIFMA stated that it "fully supports the substance of the proposed

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1 See Securities Exchange Act Release No. 71372 (January 23, 2014), 79 FR 4793 (January 29, 2014) (Notice of Filing File No. SR-FINRA-2014-003).

2 See Letter from Sean Davy, Managing Director, Corporate Credit Markets Division, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, SEC, dated February 18, 2014 ("SIFMA") and Letter from Suzanne Rothwell, Managing Member, Rothwell Consulting LLC, to Elizabeth M. Murphy, Secretary, SEC, dated February 10, 2014 ("Rothwell").

1735 K Street, NW
Washington, DC
20006-1506
t 202 728 8000
www.finra.org

revisions and believes that the proposed changes will benefit all offering participants by reducing unnecessary costs and burdens, while continuing to preserve important investor protection standards."

Rothwell also supported the proposed amendments, with the exception of narrowing the scope of the definition of "participation or participating in a public offering" to exclude an "independent financial adviser" that provides advisory or consulting services to an issuer (the "Adviser Proposal"). Rothwell recommended that various requirements of the corporate financing rules continue to apply to an independent financial adviser. Specifically, Rothwell recommended that the Adviser Proposal be revised to require: (1) an independent financial adviser to comply with the information filing requirements under Rule 5110(b)(6);[3] (2) the disclosure in the prospectus of information about an independent financial adviser's consulting arrangement, acquisitions of securities and any conflict of interest under Rule 5110(c)(2)(C) and Rule 5121(a)(1); (3) that any option, warrant or convertible security acquired by an independent financial adviser during the 180-days prior to the filing of the registration statement ("180-day review period") comply with the restrictions in Rule 5110(f)(2)(H) (with the exception of subparagraph (ii));[4] and (4) the independent financial adviser comply with the 180-day lock-up restriction in Rule 5110(g) with respect to any securities of the issuer acquired during the 180-day review period. Rothwell also requested that Rule 5110 provide additional guidance on the permissible scope of activities of an independent financial adviser.

FINRA Response

Rule 5110(a)(5) defines "participating in a public offering" to include "participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis" and the "furnishing of customer and/or broker lists for solicitation." Also included within the definition of "participating in a public offering" is participation in "any advisory or consulting capacity to the issuer related to the offering." The proposed

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3 Subject to certain exceptions, Rule 5110(b)(6)(A)(iii) requires filers to disclose to FINRA information about the association or affiliation with any member of the officers, directors, and certain owners of the issuer. The proposed rule change would reduce the scope of this provision from requiring disclosure about the association or affiliation of the specified parties with "any member" to "any participating member," thereby excluding an independent financial adviser.

4 Rule 5110(f)(2)(H) details the prohibited terms for options, warrants or convertible securities that may be issued as underwriting compensation.

amendments would amend the definition of "participating in a public offering" to provide that an "independent financial adviser" that provides advisory or consulting services to an issuer would not be deemed to be "participating" in the public offering of an issuer's securities for purposes of the rule. The amendments would define "independent financial adviser" 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.

When it proposed amending the definition of "participating in a public offering," FINRA considered the benefits to issuers seeking to procure the services of independent financial advisers under terms negotiated between the parties and the potential for overreaching or abuse by independent financial advisers that are registered as broker-dealers. FINRA concluded that the potential for abuse is minimized when an independent financial adviser is not engaged in, or affiliated with any entity that is engaged in, the solicitation or distribution of the offering. In this context, an issuer is not depending on the independent financial adviser to raise needed capital, and the independent advice provided by the adviser is not conflicted by financial benefits that derive from the value at which shares are priced, the amount (if any) of capital raised, or the type of transaction involved.

The essential purpose of the corporate financing rules is to prohibit the imposition of unfair or unreasonable underwriting terms and arrangements on issuers by members participating in a public offering. This risk is minimized when a member provides only advisory or consulting services. FINRA's experience over the past ten years corroborates this view. In FINRA's review of public offerings filed under Rule 5110 in the last decade, the staff has not identified abusive underwriting terms and arrangements associated with firms that would meet the definition of independent financial adviser under the proposed amendments.

Consequently, FINRA believes that the exclusion from the corporate financing rules for independent financial advisers is appropriate. FINRA clarifies, as requested by Rothwell, that the amendment would operate to exclude an independent financial adviser, acting solely in that capacity, from compliance with all provisions of Rule 5110, Rule 5121 and Rule 2310, including the provisions listed by Rothwell. Moreover, FINRA does not believe that the filing requirements in Rule 5110(b)(6) or the disclosure requirements in Rule 5110(c)(2)(C) regarding the independent financial adviser and its arrangements and conflicts are relevant to the rule that regulate the underwriting terms and arrangements in public offerings. This information assists investors in understanding potential conflicts

raised by the underwriters' financial interests in the issuer. These conflicts are not raised by independent financial advisers that do not underwrite an offering or participate in its solicitation or distribution to investors.

Rothwell focused particular attention on the proposed change to Rule 5110(b)(6)(A)(iii), which would eliminate the filing requirement for an independent financial adviser regarding the association or affiliation of officers, directors, greater-than-5% shareholders, and any acquirer of the issuer's securities during the 180-day period immediately preceding the filing date of the public offering ("association, affiliation and acquirer information"). Rothwell asserted that this filing obligation should continue to apply to independent financial advisers because such filings potentially could allow FINRA to identify regulatory issues and "it is possible that the SEC may [] 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." While FINRA appreciates Rothwell's concerns, the facts and FINRA's experience support the elimination of the filing and disclosure requirements for independent financial advisers regarding such information.

The association, affiliation and acquirer information from an underwriter assists investors in understanding potential conflicts raised by the underwriter's financial interests in the issuer. As noted above, this conflict is unlikely to arise when an independent financial adviser is not engaged in underwriting the offering, or otherwise participating in its solicitation and distribution. Moreover, based on its experience with these provisions over the past decade, FINRA has not identified regulatory benefits from disclosure that justify the burden of requiring independent financial advisers to file and disclose this information. FINRA also believes that targeted filing and disclosure requirements that focus squarely on underwriting compensation and arrangements would enhance the effectiveness of these provisions.

FINRA also does not agree, as Rothwell suggested, that any securities acquired by an independent financial adviser during the 180-day review period should be subject to certain restrictions that currently apply to underwriting compensation, including the lock up provision. Rule 5110 imposes requirements on securities held by underwriters and their affiliates due to their conflicts. As noted above, FINRA does not believe that the same kind of conflicts exist for independent financial advisers that do not have the leverage and influence over the pricing and other terms of an offering exercised by underwriters. Thus, any compensation that an independent financial adviser receives

should not be included as underwriting compensation or be subject to any related restrictions.

Rothwell also requested guidance on the types of activities that would be permitted and prohibited for an independent financial adviser. In particular, she requested clarification of the meaning of "solicitation or distribution of the offering." This term is consistent with well-established principles under the Securities Act of 1933 and FINRA rules. Indeed, the existing definition of "participation or participating in a public offering" in Rule 5110(a)(5) already includes "participation in the distribution" and furnishing of customer or broker lists "for solicitation." Of course, as part of the filing program, FINRA often addresses factual questions specific to a particular filing and we would be prepared to do so with respect to the interpretation of the permissible services of independent financial advisers as well.

FINRA believes that the foregoing fully responds to the issues raised by the commenters. If you have any questions, please contact me at 202-728-8200 or James S. Wrona, Vice President and Associate General Counsel, at 202-728-8270.

Sincerely,

Kathryn M. Moore
Associate General Counsel