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August 27, 2019

Submitted via email to: rule-comments@sec.gov

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: Notice of Filing of a Proposed Rule Change to
Amend FINRA Rule 5130 (Restrictions on the Purchase
and Sale of Initial Equity Public Offerings) and Rule
5131 (New Issue Allocations and Distributions)
(SEC File Number SR-FINRA-2019-022)**

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") in response to the request for comments by the Securities and Exchange Commission with respect to a proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA") to amend FINRA Rules 5130 and 5131 (the "Proposed Rule Change"), as more fully set forth below.¹

This letter was prepared by members of the Committee's Subcommittee on FINRA Corporate Financing Rules. 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 should not be construed as representing the official policy of the ABA. In addition, this letter does not represent the official position of the Section, nor does it necessarily reflect the views of all members of the Committee.

According to the Release, FINRA is proposing to amend FINRA Rules 5130 and 5131 (collectively, the "New Issue Rules") to "exempt additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments and exempt certain types of offerings from the scope of the rules."²

The Committee enthusiastically supports FINRA's efforts to expand and align the New Issue Rules and believes the proposed changes will generally be

¹ See SEC Release No. 34-86558 (August 2, 2019) (the "Release"). See also FINRA Regulatory Notice 17-14 (April 2017) ("Notice 17-14") regarding Capital Formation rules generally.

² See Release at p. 1.

welcomed by member firms. However, as discussed below, the Committee sees room for further improvement in various areas and we believe additional modifications to the New Issue Rules along the lines discussed below would further FINRA's goals as expressed in the Release.³

A. Rule 5130

1. Proposed Rule 5130(c)(6) – General Exemptions

FINRA is proposing to amend the current exemption for foreign investment companies to provide an alternative means for establishing that the entity is “widely held” for purposes of the rule. The Committee agrees that this is a helpful change. However, in connection with this proposed amendment, FINRA is also proposing to add to the exemption a further condition that the entity “was not formed for the specific purpose of investing in new issues.” The Committee does not believe that foreign investment companies that are formed to invest in new issues should be foreclosed from relying on this exemption. Instead, we believe that this new condition should be modified to require that the entity not be formed for the specific purpose of *permitting restricted persons to invest in new issues*.

2. Proposed Rule 5130(d) – Issuer-Directed Securities

FINRA is proposing to better align the provisions of Rule 5130(d) and Supplementary Material .01 to Rule 5131 by amending Rule 5130(d) to, among other things, expressly provide that allocations may be directed by affiliates and selling shareholders in addition to the “issuer” of the offered securities. The Committee supports and agrees with this modification. In addition, based on the experience of certain of our members with past interpretive requests in respect of which FINRA staff has provided positive confirmatory guidance, the Committee suggests that FINRA amend paragraph (d)(1)(B) of Rule 5130 to expressly include and acknowledge “franchisee” relationships. In particular, we suggest that this provision should be modified as follows:

“(B) an account in which any restricted person specified in paragraphs (i)(10)(B) or (i)(10)(C) of this Rule has a beneficial interest, unless such person, or a member of his or her immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent, *or of a franchisee of any of the foregoing entities...*”

³ As described by FINRA in the Release at p. 3:

Rule 5130 protects the integrity of the public offering process by ensuring that: (1) [m]embers make bona fide public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including members and their associated persons, do not take advantage of their insider position to purchase new issues for their own benefit at the expense of public customers.

Rule 5131 addresses abuses in the allocation and distribution of new issues. Among other things, the rule prohibits the practice of “spinning,” which is the allocation of new issues by a [member] firm to executive officers and directors of the firm's current, former or prospective investment banking clients.

The Committee also suggests that FINRA take this opportunity to clarify that the prohibition on allocations by an issuer (and, if amended as proposed, affiliates and selling shareholders) to an “account in which any restricted person specified in paragraphs (i)(10)(B) or (i)(10)(C) of this Rule has a beneficial interest” is not meant to supersede or render inapplicable the so-called *de minimis* exemption set forth in Rule 5130(c)(4).⁴

3. Proposed Rule 5130(i) – Definitions

(i) FINRA proposes to add to the list of offerings not encompassed by the definition of “new issue” offerings that are conducted pursuant to Regulation S under the Securities Act of 1933 or that are otherwise made outside of the United States or its territories.⁵ The Committee supports this modification and agrees that such offerings should be excluded from the scope of the rule.

In addition, the Committee believes that FINRA should take this opportunity to clarify that this rule (and, similarly, Rule 5131) is not intended to apply to a non-U.S. broker-dealer that is participating in a U.S. registered initial public offering (“IPO”) under circumstances where the non-U.S. broker-dealer is allocating securities to its own non-U.S. clients for its own purposes and is not acting as a “conduit” for, nor acting on behalf or at the direction of, a FINRA member. That is, the non-U.S. broker-dealer may allocate new issue securities in such situation to a non-U.S. investor that would otherwise fall within the definition of “restricted person” under the rule. We note that, even in such case, Rule 5130(a)(2) would still prevent FINRA members and their associated persons from purchasing new issue securities in “any account in which such member or person associated with a member has a beneficial interest,” except as otherwise permitted in the rule.

(ii) FINRA proposes to exempt certain sovereign entities that own, directly or indirectly, U.S. registered broker-dealers from being deemed “restricted persons” under Rule 5130. The Committee supports and agrees with this exemption. As noted in the Release, while such sovereign entities are sometimes generically referred to as “sovereign wealth funds,” there is no standard definition of such term either in the federal securities laws or across jurisdictions.⁶ In order to better capture the concept and the intended scope of the exemption, we suggest that the definition of “sovereign entity” be modified as provided below (note that these modifications reflect some of our members’ experiences in representing such entities and how they describe themselves):

“Sovereign entity” means a sovereign nation or a pool of capital or an investment fund or other vehicle owned or controlled by a sovereign nation and created for the purpose of making investments on behalf or for the benefit of the sovereign nation.

⁴ Rule 5130(c)(4) provides a general exemption for an account in which the beneficial interests of restricted persons do not exceed in the aggregate 10% of such account.

⁵ See proposed change to Rule 5130(i)(9)(A).

⁶ See Release at p. 10, fn 27.

4. Additional Comments on Rule 5130

(i) The Committee's members are often asked to advise on whether and to what extent Rule 5130 applies to affiliates of a broker-dealer that are outside the broker-dealer's ownership chain. For example, if a private equity fund ("Fund X") purchases a 25% indirect interest in an SEC-registered broker-dealer and is thus listed on Schedule B of the broker-dealer's Form BD, the question is whether accounts of other portfolio companies owned by Fund X (and which portfolio companies are outside the ownership chain of the broker-dealer) would be "restricted persons" under Rule 5130 because of the beneficial interest of Fund X in the account. The Committee believes that the beneficial interest of Fund X in the account of the portfolio company is sufficiently attenuated so as not to raise the policy concerns underlying the rule and, thus, that the portfolio company should not be restricted from purchasing new issues. In any event, because we believe there is confusion as to the scope of the rule in this regard, and to achieve consistency in approach, the Committee believes it would be helpful if FINRA provided guidance on this question.

(ii) The Committee notes that Supplementary Material .02(b) to Rule 5131 provides for "look-through" relief for certain types of accounts. We believe that the same issue addressed by this guidance is present in allocations under Rule 5130. Accordingly, to address this issue and to better align Rules 5130 and 5131, we believe a similar concept should be incorporated into Rule 5130.

(iii) Rule 5130(b) currently provides that before selling a new issue to any account, a FINRA member must in good faith have obtained within the twelve months prior to such sale, a representation from the beneficial owner or conduit entity that the account is eligible to purchase new issues in compliance with the rule. Accordingly, failure to obtain such documentation in respect of an account constitutes a violation of the rule even if the account being allocated new issue securities is not a "restricted person" as defined in the rule and the FINRA member has established its reasonable belief by other means. Moreover, the requirement under Rule 5130(b) does not take into account that a person may not be eligible to purchase new issues as a general matter, but may be eligible to purchase new issue securities in a particular offering due to a "one-off" transaction-specific exemption, such as the anti-dilution or issuer-directed sale provision. For purposes of determining whether the rule has been violated, the Committee believes that Rule 5130, like Rule 5131, should focus on whether an allocation has been made to a person that is not eligible to receive such allocation under the particular provisions of the rule and not whether the FINRA member has simply failed to obtain an annual written certification as to an account's eligibility status. Like Supplementary Material .02(a) to Rule 5131, Rule 5130 should provide that a written representation obtained within the prior 12 months may be relied on to establish a reasonable basis on which to believe the account is eligible to purchase new issues, but such written representation should not be the exclusive means to

demonstrate compliance with the reasonable belief requirement or required in order to establish that the Rule has not been violated.

(iv) Rule 5130 makes reference in various place to the term “broker-dealer” but does not provide a definition of this term. The Committee believes that FINRA should clarify whether this term is meant to include, in addition to SEC-registered broker-dealers, foreign broker-dealers that are not registered or required to be registered with the SEC because they operate, *e.g.*, pursuant to an applicable exemption therefrom such as Rule 15a-6 under the Securities Exchange Act of 1934.

(v) The Committee believes the definition of “new issue” set forth in Rule 5130(i)(9) (which is relevant for purposes of both Rule 5130 and Rule 5131) should be amended to also exclude from such definition’s scope IPOs by Special Purpose Acquisition Companies (“SPACs”).⁷ As with the other types of offerings excluded from the scope of the new issue definition, SPACs offer little opportunity to trade in the aftermarket following the IPO at a premium to the initial offering price. This is because, upon completion of the IPO and before entering into an agreement to acquire or merge with a target company, a SPAC’s assets consist only of the capital it has raised in the IPO and these assets (typically, net of IPO expenses) are placed in a trust account pending such an agreement to acquire/merge. We note that FINRA (then NASD⁸) amended NASD Rule 2790 (the precursor to Rule 5130) in 2005 to exclude from the definition of “new issue” securities offerings of business development companies, direct participation programs and real estate investment trusts. In doing so, FINRA noted the similarity to certain other offerings already excluded under the definition, including securities offerings of registered closed-end investment companies and stated that the exclusion for such types of offerings is based on the fact that such offerings “typically commence trading at the public offering price with little potential for trading at a premium because the fund’s assets at the time the initial public offering trades consist of the capital the fund has raised through the offering process. Moreover, if there is a premium, it is generally small. Including such offerings within the scope of Rule 2790 would do little to further the purposes of the rule and, moreover, may impair the ability of such companies to obtain capital.”⁹ We believe this rationale is equally applicable in the case of SPAC IPOs and that a similar exclusion is thus warranted.

⁷ In general, a SPAC raises funds by selling units in an SEC-registered IPO to investors for the purpose of completing a future acquisition or merger with an operating target company that has not yet been identified. The units offered in SPAC IPOs are typically priced at \$10.00 per unit and are comprised of common stock and a warrant to purchase additional common stock in the event that the SPAC completes the acquisition/merger transaction. The SPAC generally has 18 to 24 months following the effective date of the IPO to find a suitable target and sign a purchase agreement. If the acquisition/merger transaction is not consummated within the requisite period of time, the SPAC must return the funds raised in the IPO (less applicable fees and expenses) to the investors.

⁸ References to FINRA herein are deemed to also include references to its predecessor, the National Association of Securities Dealers, Inc., or “NASD”.

⁹ See Notice to Members 05-65 (October 2005) at p. 2.

B. Rule 5131

1. Proposed Supplementary Material .04 to Rule 5131 – Anti-Dilution Provision

The Committee agrees that the inclusion of an anti-dilution provision in Rule 5131, similar to the one contained in Rule 5130, is appropriate. However, we question – both for purposes of this rule as well as current Rule 5130 – whether the three month “lock-up” for those acquiring new issue securities in accordance with the anti-dilution provision is necessary or serves a legitimate investor or market protection function.

The Committee notes that when considering the codification of the former “Free-Riding and Withholding” interpretation as NASD Rule 2790 in 2003, FINRA stated its belief that “issuers should be free to set the conditions for sales of their own securities to their employees (or employees of affiliated companies) even if such employees are otherwise restricted persons. While an issuer may decide to impose a lock-up period, the NASD does not believe that such a period should be mandated by the proposed rule.”¹⁰ Based on the foregoing, the exemption for issuer-directed securities eliminated the prior requirement under the interpretation that the issuer-directed securities be subject to a three month lock-up. We believe the same logic applies to the anti-dilution provision and thus recommend that FINRA eliminate the lock-up requirement as an element of such provision in both Rule 5130 and Rule 5131.

Moreover, we believe it would be helpful for FINRA to clarify that, in determining an account’s equity ownership position in the issuer for purposes of the anti-dilution provisions of both Rules 5130 and 5131, the acquisition date of convertible securities, options and warrants may be taken into account for purposes of satisfying the one year holding period requirement (*i.e.*, such securities will be deemed to represent an equity ownership interest in the issuer) and such securities may be included in the calculation of the account’s percentage equity ownership in the issuer as if they had been converted or exercised at the time of such calculation.

2. Additional Comments on Rule 5131

(i) The Committee believes that FINRA should take this opportunity to codify certain interpretive guidance provided informally to some of its members with regard to Rule 5131(d)’s so-called “press release” requirement.¹¹ In particular, we note that lock-up agreements in connection with IPOs are often entered into well in advance of the effective date of the registration statement for the offering (often

¹⁰ See SEC Release 34-48701 (Oct. 24, 2003).

¹¹ See Rule 5131(d)(2)(B), which provides: “At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer’s shares, the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service, except where the release or waiver is effected solely to permit a transfer of securities that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor.”

before the offering is even publicly announced). Accordingly, we recommend that FINRA clarify that the press release requirement does not apply to lock-up releases or waivers granted before the effective date of the offering. In addition, the Committee recommends that FINRA clarify that no press release is required if the lock-up release or waiver relates solely to a mechanical or other provision of the lock-up agreement and does not actually permit the securities subject to the lock-up to be sold or otherwise transferred.

(ii) FINRA stated in Regulatory Notice 10-60 that it would consider “disclosure of a release or waiver in a publicly filed registration statement in connection with a secondary offering as satisfying the requirement for an announcement through a major news service.” The Committee believes that this helpful guidance should be incorporated as Supplementary Material to Rule 5131 for ease of reference.¹²

(iii) FINRA should clarify that the two business day requirement in respect of the press release requirement is calculated by reference to the first date on which the securities subject to the lock-up may actually be sold and not the date on which the lock-up release or waiver itself is granted.

(iv) Rule 5131(d)(2)(B) provides that the press release requirement does not apply if the lock-up release or waiver is “effected solely to permit a transfer of securities that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor.” The Committee sees no logical reason for this exemption to be limited to those circumstances in which the transfer is effected “for no consideration.” Instead, the only relevant factor should be that the “transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor.” Accordingly, the Committee requests that FINRA consider modifying this provision to eliminate the “consideration” element.¹³

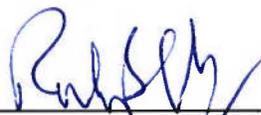
* * *

¹² See FINRA Regulatory Notice 10-60 (November 2010) at p. 8, fn 12.

¹³ In this regard, the Committee also notes that “consideration” is not a defined term and may, potentially, be viewed very broadly. For example, if securities subject to a lock-up are transferred from one spouse to another in a divorce settlement, is that a transfer for no consideration? What if the receiving spouse agreed to forego a demand for some other property in return for the securities? Again, so long as the securities continue to be subject to the same lock-up restrictions, we do not see what policy objective is served by excluding transfers for consideration from this carve-out.

We greatly appreciate the opportunity to provide comments with respect to this important rule-making effort and thank the FINRA staff for its efforts and thoughtful approach to the issues addressed by the proposed amendments. Members of the Drafting Committee are available to meet and discuss these matters with the SEC and FINRA staff and to respond to any questions.

Very truly yours,



Robert E. Buckholz
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