



August 29, 2019

Via email (rule-comments@sec.gov)

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Ms. Vanessa Countryman, Secretary

Re: Proposed Amendments to FINRA Rules 5130 and 5131 (File No. SR-FINRA-2019-022)

Dear Ms. Countryman,

The Securities Industry and Financial Markets Association (“SIFMA”) is writing in response to amendments proposed by the Financial Industry Regulatory Authority, Inc. (“FINRA”) to FINRA Rules 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and 5131 (New Issue Allocations and Distributions) (the “Proposal”).¹ We appreciate the opportunity to provide comments to the U.S. Securities and Exchange Commission (the “SEC”) on the Proposal.

SIFMA has been a long-time proponent of effective regulation of IPO allocation. In previous comment letters, including in response to FINRA Regulatory Notice 17-14 (Capital Formation) (the “17-14 Comment Letter”),² we offered suggestions for changes to FINRA Rules 5130 and

¹ *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 FINRA Rule 5131 (New Issue Allocations and Distributions)*, 84 Fed. Reg. 39029 (proposed Aug. 8, 2019).

² Letter from Sean Davy, Managing Director, Capital Markets Division, SIFMA, to Jennifer Piorko Mitchell, Office of the Corporate Secretary, FINRA, dated June 6, 2017, https://www.finra.org/sites/default/files/notice_comment_file_ref/17-14_SIFMA_comment.pdf. See also Letter from Sean Davy, Managing Director, Corporate Credit Markets Division, SIFMA, to Elizabeth M. Murphy, Secretary, SEC, dated Apr. 8, 2010, <https://www.sec.gov/rules/sro/nyse/nyse200412/nasd2003140-14.pdf> (the “2010 SIFMA Comment Letter”).

* SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly one million employees, we advocate for legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association.

5131. Our suggestions focused on maintaining investor protection and market integrity while harmonizing and clarifying the two rules, and expanding the permitted investor base for new issue securities where circumstances warrant. We are broadly supportive of the Proposal. In this letter, we suggest some revisions and additions to the proposed changes to FINRA Rules 5130 and 5131 that we believe would maintain the investor protection and market integrity goals of these rules, while further expanding the permitted investor base, reducing compliance challenges for member firms, and streamlining issuer access to capital markets.

1. Comments with respect to the Proposal

Family Offices

The Proposal seeks to better align the definition of family investment vehicle with the family office concept from the Investment Advisers Act of 1940 (the “Advisers Act”). In doing so, the Proposal expands the definition of family investment vehicle to include family members and family clients, as each term is defined under Rule 202(a)(11)(G)-1 of the Advisers Act. The Proposal includes a caveat, however, which provides that where beneficial owners of an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity must be an immediate family member, as defined in paragraph (i)(5) of Rule 5130, or a family member, as defined under Rule 202(a)(11)(G)-1 of the Advisers Act, for the entity to be considered a family investment vehicle.

While we support harmonization of the definition of “family investment vehicle,” we are concerned about the caveat that where beneficial owners of an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity must be an immediate family member (as defined in paragraph (i)(5) of Rule 5130) or a family member (as defined under Rule 202(a)(11)(G)-1 of the Advisers Act) for the entity to be considered a family investment vehicle. This caveat appears inconsistent with the intent of the Proposal.

Specifically, SIFMA believes that professional management of a family investment vehicle should not disqualify such a vehicle from proper characterization. Rather, our view is that the use of a professional fiduciary by a family investment vehicle brings all of the heightened standards and benefits of professional investment management without in any way impacting the composition or alignment of the vehicle’s owners. We therefore respectfully request that the proposed caveat to the family investment vehicle definition in Rule 5130(i)(4) be removed.

Employee Retirement Benefits Plans

The Proposal adds a new general exemption from the prohibitions of Rule 5130(a) for employee retirement benefits plans organized under and governed by the laws of a foreign jurisdiction that meet four requirements set forth in the rule. We support the adoption of this additional

exemption, but respectfully request that FINRA consider lowering the aggregate number of plan participants in proposed Rule 5130(c)(8)(A) from 10,000 to 1,000. Lowering the aggregate number of plan participants would be consistent with prior FINRA guidance on this matter and other current exemptions set forth in Rule 5130(c),³ while neither leading to any restricted person unfairly gaining access to new issue securities nor impugning the integrity of the new issue allocation process in any way. In addition, as noted in the 17-14 Comment Letter, we support and recommend expanding the scope of this exemption to also apply to domestic employee retirement benefits plans that otherwise meet the four criteria set forth in proposed Rule 5130(c)(8).⁴ This expansion would further facilitate investment in new issues without compromising the integrity of new issue allocations.

Alternative Conditions for Foreign Investment Company Exemption

The Proposal suggests two alternative methods to establish that a foreign investment company is widely held for purposes of the foreign investment company exemption set forth in Rule 5130(c)(6):

- the investment company has 100 or more direct investors; or
- the investment company has 1,000 or more indirect investors.

The Proposal also adds a third prong to this exemption, requiring that the investment company not have been formed for the specific purpose of investing in new issues. While SIFMA supports the addition of the two alternative methods set forth in proposed Rule 5130(c)(6)(B), we respectfully request that FINRA consider deleting the proposed third prong in Rule 5130(c)(6)(C). While SIFMA understands the rationale for this additional prong, given the two new alternative methods proposed to establish that a foreign investment company is widely held, we note that many funds are specifically, and for independent reasons, formed with a strategy of investing in new issue securities. The addition of this third prong would potentially exclude those funds with legitimate capital appreciation strategies from falling within this exemption, and may also exclude foreign investment companies that currently fall within this exemption (e.g., investment companies where no person owning more than 5% of the shares of the investment company is a restricted person that were formed for the specific purpose of

³ For example, common trust funds with investments from 1,000 or more accounts ((c)(2)); insurance companies funded by premiums from 1,000 or more policyholders ((c)(3)); foreign investment companies that approximate U.S. mutual funds ((c)(6)); and the current benefit plans exemptions ((c)(7) and (8)).

⁴ See, e.g., Letter from FINRA to Kevin O'Connor, Partner, Picard Kentz & Rowe LLP, dated May 1, 2015, <https://www.finra.org/rules-guidance/guidance/exemptive-letters/kevin-oconnor-picard-kentz-rowe-llp> (exempting the U.S. National Railroad Retirement Investment Trust from Rules 5130 and 5131(b)).

investing in new issues and are listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority).

Exclusion for Foreign Offerings

The Proposal adds an exclusion from the definition of “new issue” for “offerings made under Regulation S or otherwise made outside of the United States or its territories.” SIFMA supports this change and respectfully requests that FINRA confirm that this exclusion similarly applies to non-U.S. syndicate members or selling group members (including the non-U.S. affiliates of participating FINRA-member broker-dealers) of U.S. new issue offerings (including SEC-registered offerings) to the extent these broker-dealers are selling to non-U.S. investors. Such a reading of this exclusion is consistent with FINRA’s goals in proposing this change, and will avoid confusion in transactions that have a single syndicate but also involve Regulation S or offshore tranches, or that otherwise include non-U.S. broker-dealers transacting with non-U.S. investors.

Issuer-Directed Securities

To harmonize the language of Rule 5130(d) and Rule 5131.01, the Proposal modifies the language of Rule 5130(d)(1) and (2) to include not only issuer directions, but also those of affiliates and selling shareholders. The Proposal also makes changes to clarify that securities must be directed in writing for purposes of Rule 5130(d)(1), (2), and (4). We support these changes, but propose modifying the language in Rule 5130(d)(1) and (2) and Rule 5131.01 from “the issuer, its affiliates, or selling shareholders” to “the issuer, an affiliate of the issuer, or a selling shareholder” to avoid any potential confusion as to whether a single affiliate or a single selling shareholder may direct securities, as opposed to requiring all affiliates of an issuer or all selling shareholders to direct securities.

2. Additional Comments

Returned Shares

In the 17-14 Comment Letter, we proposed the addition of a *de minimis* option under Rule 5131(d)(3)(A) that allows member firms to sell returned shares in the secondary market and donate the profits anonymously to an unaffiliated charity, if the number of shares returned to the syndicate is 1% or less of the total size of the initial offering. We appreciate FINRA’s consideration of this request, as noted in footnote 49 of the Proposal. We respectfully request as an alternative that FINRA consider a generalized provision that permits member firms to sell returned shares trading at a premium in the secondary market, regardless of whether there is an existing syndicate short position, provided such sales are not inconsistent with Regulation M and that member firms have policies and procedures in place to ensure that any sales or

allocations are made fairly and that member firms do not receive any of the premium from these transactions (e.g., by donating the profits anonymously to an unaffiliated charity, as is currently permitted under Rule 5131(d)(3)(B)(ii)). The purpose of such proposal is to provide regulatory guidelines for dealing with returned shares that do not reduce the proceeds to the issuer, even by small amounts.

Written Representation Requirement: Request for Harmonization of Procedures

We respectfully renew our suggestion to delete the formal requirement in Rule 5130 that members obtain a representation from account holders prior to selling a new issue, and instead add a safe harbor permitting members to rely on a written representation obtained within twelve months prior to the sale of a new issue to satisfy Rule 5130(a), similar to the approach currently set forth in Rule 5131. As noted in the 17-14 Comment Letter, the current requirement of Rule 5130(b) can lead to an administrative violation of Rule 5130, even where the allocation itself was otherwise in compliance with Rule 5130. While we expect the use of written representations will continue to be the principal procedure of member firms, we do not believe that it needs to be the only way to demonstrate compliance.

We also renew our request to add clarifying language to Rule 5130(b) similar to that currently found in Rule 5131.02(b), which permits member firms, subject to certain conditions and exceptions, to rely on a written representation from a person authorized to represent an account that does not look through to the beneficial owners of any “unaffiliated private fund” invested in the account. The challenges identified by FINRA that contributed to the adoption of the current language of Rule 5131.02(b)⁵ are equally applicable to the representation required under Rule 5130(b). Therefore, we respectfully request the adoption of this single-representation approach to Rule 5130(b).

De Minimis Exemption Level under Rule 5130(c)(4)

In the 17-14 Comment Letter, we proposed raising the beneficial ownership threshold for purposes of the *de minimis* general exemption under Rule 5130(c)(4) from 10% to 25%. We respectfully request that FINRA re-consider this suggestion. Raising the threshold would increase available capital for new issue offerings while continuing to ensure that non-restricted

⁵ See Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend FINRA Rule 5131 (New Issue Allocations and Distributions), Securities Exchange Act Release No. 70957 at 4 (Nov. 27, 2013), 78 Fed. Reg. 72946, 72947 (Dec. 4, 2013).

persons receive most of the benefits of the investment. Raising the threshold to 25% would also harmonize Rule 5130(c)(4) with the *de minimis* exemption available under Rule 5131(b)(2).⁶

“Excessive” Compensation under Rule 5131(a)

SIFMA continues to support the provisions of Rule 5131 with respect to *quid pro quo* allocations. As noted in prior comment letters,⁷ however, we remain concerned that member firms may have difficulty in determining at what point compensation becomes “excessive” for purposes of Rule 5131(a). Therefore, we respectfully request that Rule 5131(a) be amended, or, alternatively, that Supplementary Material be added to Rule 5131, to state that an assessment of whether compensation is excessive will be based on all of the relevant facts and circumstances including, where applicable, the level of risk and effort involved in the transaction and the rates generally charged for the same or similar services. We believe that this language would be a helpful guide for member firms as they seek to comply with FINRA Rule 5131 and to FINRA when it examines for compliance by its member firms.

Clarity with respect to Recordkeeping Obligations

We recommend that FINRA provide confirmation that a member firm is in compliance with its recordkeeping obligations with respect to Rules 5130 and 5131 if the member firm maintains copies of, or access to, a database of 5130 and 5131 forms, which provides with respect to each relevant client, (i) a copy of the signed form, (ii) the date on which a particular client signed the respective form, and (iii) the subsequent dates that the form was re-confirmed (by negative or positive confirmation) and any corresponding documentation. We believe that such guidance would serve as a clear standard for the industry and would harmonize compliance in a manner that allows for robust examination.

“Finders and Fiduciaries” as Restricted Persons under Rule 5130

Currently, finders and fiduciaries are included within the definition of “restricted person” for purposes of Rule 5130.⁸ We believe that the inclusion of finders and fiduciaries within the definition of restricted person has been largely unworkable and has led to compliance challenges, given the periodic and case-by-case nature of the designation (*i.e.*, the definition is

⁶ In adopting the 25% threshold for purposes of the general exemption under Rule 5131(b)(2), FINRA noted that this percentage was the “most appropriate.” *Notice of Filing of Amendment No. 4 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 through 4, Relating to the Prohibition of Certain Abuses in the Allocation and Distribution of Shares in Initial Public Offerings (“IPOs”),* Securities Exchange Act Release No. 63010 at p. 4, n. 7 (Sept. 29, 2010), 75 Fed. Reg. 61541, 61542, n.7 (Oct. 5, 2010).

⁷ See, e.g., 2010 SIFMA Comment Letter.

⁸ FINRA Rule 5130(i)(10)(C).

tioned to the security being offered). Further, we have not experienced, nor are we aware of any history of, abuse by finders and fiduciaries. We respectfully request that FINRA remove finders and fiduciaries from the definition of restricted person, and we submit that doing so would not significantly alter the investor protection and market integrity goals of the rule. Generally, persons who fall within this category are not those who are in a position to provide *quid pro quo* services in exchange for a new issue allocation. This may especially be the case for persons acting in a fiduciary capacity (e.g., attorneys and accountants), given that these professions are subject to standards and norms that do not lend themselves to the allocation of securities in exchange for services, let alone for any special services. In the event that FINRA determines that finders and fiduciaries should not be removed from the definition of restricted person, we respectfully request that FINRA consider as an alternative, for the reasons stated above, removing the reference to Rule 5130(i)(10)(C) from the issuer-directed securities exemption of Rule 5130(d).⁹

Persons Listed on Schedule C of Form BD

Currently, the list of persons who are restricted persons by virtue of owning a broker-dealer includes persons listed on Schedule C of Form BD who otherwise meet the criteria under subparagraph (E)(i) and (E)(ii).¹⁰ We respectfully request that this provision be deleted, as it is redundant with the provisions of Rule 5130(i)(10)(E)(i) and (ii).

Portfolio Managers

The list of restricted persons for purposes of Rule 5130 includes portfolio managers, defined as any person who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account.¹¹ In the NASD Notice to Members announcing the adoption of the predecessor to Rule 5130 (NASD Rule 2790), the NASD noted that the designation and definition are based upon a person's activities, rather than status.¹² While we agree that focusing on persons with the authority to buy or sell securities is the right category definition, there can be an unnecessary

⁹ FINRA Rule 5130(d)(1)(B).

¹⁰ These include: "(i) Any person listed, or required to be listed, in Schedule A of a Form BD (other than with respect to a limited business broker-dealer), except persons identified by an ownership code of less than 10%," and "(ii) Any person listed, or required to be listed, in Schedule B of a Form BD (other than with respect to a limited business broker-dealer), except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A identified by an ownership code of less than 10%."

¹¹ FINRA Rule 5130(i)(10)(D).

¹² See NASD Notice to Members 03-79, *SEC Approves New Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities); Replaces Free-Riding and Withholding Interpretation* (Dec. 2003), p. 13, http://www.complinet.com/file_store/pdf/rulebooks/nasd_0379.pdf.

focus on persons whose job title is “portfolio manager” (or similar title) but who have no authority to buy or sell securities. Often portfolio managers, with titles such as “portfolio manager” or “chief investment officer,” are responsible for establishing or evaluating the general strategy or composition for a given portfolio. This strategy is then passed down to individuals on the trading desk, who execute the strategy and are actually the individuals in a position to direct brokerage business to a specific member firm or firms. Because of this, we respectfully request that the definition, or the category title, be amended to focus on individuals with the power to direct brokerage business, rather than individuals who solely select or allocate securities.

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SIFMA reiterates its general support for the Proposal and thanks FINRA and the SEC for their efforts and the opportunity to provide comments. If you have any questions regarding SIFMA’s views or require additional information, please do not hesitate to contact the undersigned at [REDACTED] or our counsel on this matter, Russell D. Sacks of Shearman & Sterling LLP, at [REDACTED].

Very truly yours,



Aseel M. Rabie
Managing Director and Associate General Counsel

cc: Robert L.D. Colby, Chief Legal Officer, FINRA
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