

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62702; File No. SR-FINRA-2010-026)

August 12, 2010

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving the Proposed Rule Change to Adopt FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) in the Consolidated FINRA Rulebook

I. Introduction

The Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) on May 20, 2010, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to adopt FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) (“Rule”) in the Consolidated FINRA Rulebook. This proposal was published for comment in the Federal Register on June 4, 2010.<sup>3</sup> The Commission received one comment on the proposal,<sup>4</sup> and a letter from FINRA responding to the comment letter.<sup>5</sup> This order approves this proposed rule change.

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Exchange Act Release No. 62199 (June 1, 2010), 75 FR 31825 (June 4, 2010) (SR-FINRA-2010-026).

<sup>4</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, American Bar Association dated June 22, 2010 (“ABA letter”).

<sup>5</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Stan Macel, Assistant General Counsel, FINRA, dated July 23, 2010 (“FINRA Response Letter”).

## II. Description of the Proposed Rule Change

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),<sup>6</sup> FINRA proposed to adopt NASD Rule 2720 (Public Offerings of Securities With Conflicts of Interest) without material change as FINRA Rule 5121 in the Consolidated FINRA Rulebook.

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,<sup>7</sup> from participating in a public offering, unless certain other requirements are met.<sup>8</sup> There is no comparable Incorporated NYSE Rule.

---

<sup>6</sup> The current FINRA rulebook consists of (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

<sup>7</sup> As defined in NASD Rule 2720(f)(5), a conflict of interest exists, if at the time of a member’s participation in an entity’s public offering, any of the following four conditions applies: (1) the securities are to be issued by the member; (2) the issuer controls, is controlled by or is under common control with the member or the member’s associated persons; (3) at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be (i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or (ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate; or (4) if, as a result of the public offering and any transactions contemplated at the time of the public offering (i) the member will be an affiliate of the issuer; (ii) the member will become publicly owned; or (iii) the issuer will become a member or form a broker-dealer subsidiary. NASD Rule 2720 defines several terms for purposes of the rule, including “entity,” “control,” and “common control.”

<sup>8</sup> 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.

On June 15, 2009, the SEC approved a proposed rule change to modernize NASD Rule 2720 (the “2009 Rule Change”).<sup>9</sup> The 2009 Rule Change became effective on September 14, 2009.<sup>10</sup>

The proposed rule change would adopt NASD Rule 2720 without material change as FINRA Rule 5121 in the Consolidated FINRA Rulebook. The proposal would make minor changes to the Rule to reflect the new terminology conventions of the Consolidated FINRA Rulebook.

### III. Comment Letters

The Commission received one comment letter in response to the proposed rule change.<sup>11</sup> The Commission also received FINRA’s response to comments.<sup>12</sup> While the commenter had no objection to the proposal itself to move NASD Rule 2720 without material change into the Consolidated FINRA Rulebook, the commenter did offer a number of comments about the substance of the Rule. The specific comments from this letter, as well as FINRA’s response, are discussed in detail below.

The commenter suggested that FINRA clarify what “participation in a public offering” means for purposes of the Rule and suggested an alternative definition. FINRA responded that “participation in a public offering” for purposes of the Rule are already widely understood and

---

<sup>9</sup> See Securities Exchange Act Release No. 60113 (June 15, 2009), 74 FR 29255 (June 19, 2009) (File No. SR-FINRA-2007-009).

<sup>10</sup> 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).

<sup>11</sup> See ABA Letter.

<sup>12</sup> See FINRA Response Letter.

that the alternative definition suggested by the commenter would be an inappropriate narrowing of the Rule.

The commenter also suggested that FINRA clarify what “primarily responsible for managing the public offering” means for purposes of the Rule and suggested an alternative for the term. FINRA asserted that the commenter’s alternative would inappropriately narrow the application of the Rule and that the Rule as written provided FINRA flexibility to keep pace with developments in the underwriting process while also acknowledging the varied roles its members play currently.

The commenter also offered an alternative to the experience standard necessary to qualify as a “qualified independent underwriter” under the Rule. FINRA recognized the issue raised by the commenter and stated their intention to take a more comprehensive review of the matter. FINRA also pointed out that they have exemptive authority in extreme circumstances where the standard may unnecessarily limit the availability of a qualified independent underwriter.

The commenter also suggested that FINRA clarify that the definition of “affiliate” used in the Rule only applies to the Rule. FINRA did not agree with this change and stated the thrust of this comment was directed at rules beyond the rule proposal.

Lastly, the commenter suggested that FINRA amend the definition of “entity” used in the Rule to except financing instrument-backed securities from being considered an “entity” for purposes of the Rule. FINRA points out that these securities were purposefully not included in the exceptions to the definition of “entity.”

#### IV. Discussion and Findings

After careful review of the proposed rule change, the comment, and FINRA’s response to the comment, the Commission finds that the proposed rule change is consistent with the

requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>13</sup> In particular, the Commission believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>14</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission believes that the Rule continues regulation that protects investors in offerings where the member has a conflict of interest. The Commission also notes

---

<sup>13</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78o-3(b)(6).

that FINRA is adopting NASD Rule 2720 into the Consolidated FINRA Rulebook as FINRA Rule 5121 without material change.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change (File No. SR-FINRA-2010-026) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Florence E. Harmon  
Deputy Secretary

---

<sup>15</sup> 15 U.S.C. 78s(b)(2).

<sup>16</sup> 17 CFR 200.30-3(a)(12).