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April 6, 2010

Via e-mail: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Re: SR-NASD-2003-140; Release No. 34-61690
Prohibition of Abuses in Allocating Initial Public Offerings

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee" or "we") of the Section of Business Law (the "Section") of the American Bar Association ("ABA") in response to the request by the Securities and Exchange Commission (the "Commission" or "SEC") for comments with respect to the republication of proposed Financial Industry Regulatory Authority, Inc. ("FINRA") Rule 5131 that is intended to regulate certain abuses in the allocation and distribution of shares in initial public offerings ("IPOs"), as set forth in the release referenced above (the "Proposing Release" or "Revised Proposal"). This letter was prepared by members of the Committee's FINRA Corporate Financing Rules Subcommittee with input from other members of the Committee.

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, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

I. INTRODUCTION AND REQUEST FOR EXTENSION OF TIME

FINRA first published the proposed rule change in SEC Release No. 34-50896 (December 20, 2004); 69 F.R. 77804 (December 28, 2004) (the "Initial Proposal"). We appreciate that FINRA has revised the Initial Proposal in a number of respects in response

to comments, including those in our 2005 comment letter (the "Initial Comment")[1]. The changes made in the Revised Proposal would, among other things, (i) facilitate compliance with SEC Regulation M, (ii) limit the regulation of returned securities to securities that trade at a premium in the secondary market, (iii) shorten the six-months forward-looking provision to three months and delete the six-months forward-looking presumption of the proposed "spinning" rule, (iv) adopt an issuer-directed shares allocation exception to the "spinning" rule, (v) adopt an exception from the notification and announcement requirements for a waiver of a lock-up where a transfer is not for consideration and the transferee agrees to the remaining lock-up restriction, (vi) modify the market order provision to relate to the commencement of trading on the secondary market, and (vii) adopt definitions of "IPO" and "investment banking services."

We continue to support the concept of rules that would prevent the abuses that were identified in connection with corporate IPOs during what was known as the "IPO Bubble," and we believe that many of FINRA's changes made to the proposed rule represent an improvement. However, in our view, FINRA's proposed changes to the prohibition on "spinning" (and certain definitions applicable to the "spinning" and other provisions) are overly broad and are not effectively targeted to the types of offerings in which abuses are likely to take place. If adopted, these rules would place significant compliance burdens on member firms selling IPO shares without concomitant benefits; and may reduce the ability of a wide category of persons to purchase IPO shares despite the absence of an intention by member firms to obtain an illicit benefit from such sales. The proposal to impose a mandatory 12-month ban on investment banking relationships would have even greater negative consequences; the limitations on the freedom of companies to enter into engagements with investment banks may be injurious to those companies and to their shareholders.

As stated in our Initial Comment, "the proposed rules should operate effectively to prevent manipulative activity while not inhibiting legitimate allocation and distribution practices and without imposing unnecessary burdens on the broker/dealer industry."[2] The comments in this letter are intended to identify ways this goal can be achieved.

Request for Extension of the Comment Period: The Revised Proposal provides for only a 21-day comment period. Moreover, the rule filing submitted with respect to the Revised Proposal indicates that FINRA has not granted an extension of time for the Commission to take action on the Revised Proposal beyond the 35-day statutory period under Section 19(b)(2) of the Securities Exchange Act of 1934 (the "Exchange Act"), which is measured from the date of publication of the Revised Proposal in the Federal Register. We are concerned that the 21-day comment period will not provide an adequate opportunity for interested and affected constituencies to properly prepare and submit comments on the Revised Proposal, and that neither the Commission nor FINRA staff will have sufficient time to fully consider the comments received nor to make any changes to the Revised Proposal in response to any

[1] See Letter from Dixie L. Johnson, Chair, Committee on Federal Regulation of Securities, Business Law Section, American Bar Association to Jonathan Katz, Secretary, SEC, dated March 8, 2005.

[2] Initial Comment, at 2.

comments received because the Commission must act by the 35th day from the Revised Proposal's publication date to either approve or disapprove the Revised Proposal.

In our preparation of this letter, it has become apparent to us that the 21-day comment period has not afforded us adequate time to fully assess the impact of the Revised Proposal and the compliance issues it will create. There has simply been insufficient time to review FINRA's responses to the comments it received on the Initial Proposal or to gather information from industry professionals regarding the compliance issues and burdens that would result from the Revised Proposal. We also believe that there may be segments of the broker/dealer industry that are as yet unaware of the possible impact the "spinning" rule may have on their businesses because of the expansive definition of "IPO."

Under Section 19(b)(2) of the Exchange Act, the Commission has authority to extend the period of time for Commission action up to 90 days from the date of publication if the Commission determines that such longer period is appropriate and publishes its reasons for so finding, without the consent of the self-regulatory organization. We hereby request that SEC staff extend the comment period for a total of sixty days, which would be consistent with the time period normally applicable to SEC rule proposals that have significance comparable to that of the Revised Proposal.[3] In addition, we ask that the SEC consider including, in connection with any such extended comment period, a specific request for comment from those segments of the broker/dealer industry that sell real estate investment trust, limited liability company, limited partnership, and commodity pool securities. These segments, and certain other segments of the broker-dealer community as well, will be subject to the provisions of the Revised Rule although offerings for the securities described above were not the subject of the IPO abuses, as more fully discussed below. Such an enhanced request for comment will help to ensure that these affected segments of the broker/dealer industry are made aware of the potential implications of the Revised Proposal to their businesses, and will have an opportunity to comment.

II. SPECIFIC COMMENTS

***Definition of "Initial Public Offering"*:** The Revised Proposal includes, as we recommended in the Initial Comment, a proposed definition of "initial public offering" in Rule 5131(e)(3), which would limit the application of the Revised Proposal to an SEC-registered offering by a company that, as a result of the offering, becomes a reporting company under Section 12 of the Exchange Act or becomes obligated to file periodic reports under Section 15(d) of the Exchange Act. However, the Initial Comment went on to say that "the definition must be further clarified in order to exclude offerings of types of equity securities that are not subject to the potential for aftermarket abuses that are associated with corporate IPOs because the aftermarket for such offerings have historically traded at a discount to the IPO price."[4] Because the Revised Proposal does not contain the requested clarifying or narrowing language, the rule, if

[3] We believe that the 21-day comment period in this case does not comply with the requirement of the Administrative Procedures Act that rule proposals be published in a manner that provides interested parties an adequate opportunity to comment, offer amendments, or to object to the regulation.

[4] Initial Comment, at 12.

adopted as proposed, will have a wholly unnecessary impact on offerings in which there is no prospect of abuse.

While, as FINRA states, the proposed definition of IPO is consistent with that in the *Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings* (the "*Voluntary Initiative*"),[5] the *Voluntary Initiative* was further limited by the SEC to "hot" IPOs, which the SEC defined as "any IPO that trades at a premium in the secondary market when the secondary market begins." In comparison, the Revised Proposal would apply to an IPO of any equity security,[6] whether or not the security trades in the secondary market, and, if such a secondary market exists (listed or unlisted), whether or not the security trades at a premium to the IPO price when the secondary market begins.

We are gravely concerned that adoption of the proposed rule without further limitations to the scope of the term "IPO" will impose an unreasonable burden on the broker/dealer industry. In our view, this burden is not justified under Section 15A of the Exchange Act by the need to prevent fraudulent and manipulative acts and practices or to promote just and equitable principles of trade. Unless an equity security trades in a secondary market under circumstances where such security is likely to immediately trade at a premium following an IPO, we believe that there is no incentive for a FINRA member to engage in *quid pro quo* arrangements or "spinning" allocations, nor are rules necessary in the public interest to regulate penalty bids, reporting of indications of interest to the issuer, lock-up arrangements, release or waiver of lock-up determinations, the treatment of returned securities, and the handling of secondary market orders.

In many cases, "best-efforts" underwritten offerings of SEC-registered limited partnership, limited liability company, real estate investment trusts and "direct participation program"[7] securities are neither listed nor traded in the secondary market. FINRA may agree that the Dealer Manager of such an offering is not subject to the requirements to report indications of interest and final allocations, when such offerings generally are accomplished by subscription procedures. However, FINRA members that conduct an investment banking business (which includes private and public offerings and investment banking services in connection with mergers and acquisitions) would be prohibited from selling such an illiquid security to an executive officer or director of any public or private company that was, is, or may become an investment banking services client of the FINRA member within the relevant restricted periods of the "spinning" prohibition (the "Spinning Restricted Period"). This category of investor is highly qualified to purchase such illiquid securities and, in our view, no regulatory benefit is achieved by depriving such investors of the opportunity to make this kind of investment. IPOs involving such securities (as well as asset-backed, commodity pool, preferred, trust preferred, and convertible preferred securities) do not generally trade at a premium to their

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5 http://www.sec.gov/news/press/globalvolinit.htm.

[6] Although not defined in the Revised Proposal, we believe that FINRA would likely rely on the definition of "equity security" in Section 3(a)(11) of the Exchange Act, consistent with the definition of 'new issue" in FINRA Rule 5130.

[7] *See*, definition of "direct participation program" in FINRA Rule 2310(a)(4).

initial public offering price in the secondary market. Moreover, the Revised Proposal would apply to offerings that technically constitute IPOs, but do not confer upon a member the ability to direct allocations or provide an opportunity for "spinning" profits, such as (i) offerings that may occur as a result of a rights offering, merger or acquisition, or exchange offer; (ii) offerings of securities by a foreign private issuer where there is a pre-existing trading market outside the United States; and (iii) offerings by a business development company. In each case, these offerings are excluded under FINRA Rule 5130(i)(9) from the FINRA "New Issue" rule. Given that the New Issue rule is intended to regulate abuses with respect to IPOs, we believe that proposed FINRA Rule 5131 should be no broader in scope than FINRA Rule 5130 and, in addition, should be limited to "hot" IPOs as defined in the *Voluntary Initiative,* given the significant compliance burdens that would be imposed by the Revised Rule.

We therefore recommend that the Revised Proposal be revised to: (1) limit the definition of IPO to a "hot" issue, as defined by the SEC in 2003 in the *Voluntary Initiative*; and (2) codify exemptions or exceptions from the definition of IPO in proposed Rule 5131(e)(3) for the types of securities and offerings that are exempted/excepted by FINRA Rule 5130(i)(9).

Definition of "Investment Banking Services": In our Initial Comment, we recommended that the term "investment banking services" be defined to be limited to services in connection with SEC-registered underwritten offerings. Instead, FINRA has proposed a significantly broader definition of "investment banking services," consistent with the definition in NASD Rule 2711(a)(3).[8] In light of this broader general definition, we believe that the term "investment banking services" as used in proposed FINRA Rule 5131 and thus the threshold for the application of the proposed rule, should be subject to a materiality standard. As proposed, the prohibitions of the rule would be triggered by a member providing any "investment banking services" compensation, no matter how immaterial in amount. Without a *de minimis* standard, the application of the rule will be overly broad and compliance with the rule will be exceedingly difficult. We suggest instead that the term "investment banking services" be revised to require that the aggregate agreed upon fees paid, or payable, by a company to a member in respect of the provision of services by the member to such company, as the scope of such services is currently defined in the proposed rule, must have exceeded $1 million during the past 12 month period (the "Materiality Threshold").

Definitions of "Executive Officer" and "Director": The proposed rule does not set forth any definition of either "executive officer" or "director." We suggest that FINRA propose specific definitions therefor, such as the definition of "director" in Section 3(a)(7)[9] of the Exchange Act and the definition of "executive officer" in Rule 3b-7[10] thereunder.

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[8] FINRA is currently in the process of converting the rules of the National Association of Securities Dealers, Inc. ("NASD") to FINRA rules. Therefore, an NASD rule that has not, as yet, been so converted is referred to herein as an "NASD rule."

[9] Pursuant to Section 3(a)(7) of the Exchange Act, the term "director" means "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."

[10] Pursuant to Rule 3b-7 under the Exchange Act, the term "executive officer" means a "president, any vice president…in charge of a principal business unit, division or function (such as, sales, administration, or finance), any other officer who performs a policy making function or any other person who performs similar policy making

Definition of "Account of an Executive Officer or Director": The proposed definition of "account of an executive officer or director" (the "Account Definition") for purposes of the proposed "spinning" prohibition raises difficult compliance issues with respect to allocations of IPO shares to private investment funds. Pursuant to proposed FINRA Rule 5131(e)(1)(B), an investment fund that is not registered under the Investment Company Act of 1940 (the "1940 Act"), and in which one or more executive officers or directors (or materially supported persons thereof) have a "financial interest", would constitute an "account of an executive officer or director" under the proposed rule, unless (i) no such person has "discretion or control" over such investment fund and (ii) such persons "collectively own" interests representing no more than 25% of the assets of such investment fund. FINRA does not propose to define the terms "financial interest" or "discretion or control," leaving the broker/dealer industry without any guidance on these vital concepts. We do not support adoption of the Account Definition as currently drafted, especially in view of the absence of a practical means by which members will be able to determine their compliance with the proposed "spinning" prohibition.

Under the proposed Account Definition, we are concerned that the executive officers and directors of an investment fund's general partner, managing member or investment manager would be deemed to have a "financial interest" in the fund as well as "discretion or control" over such fund, even if the interests, collectively, of such persons would not exceed 25% of the assets of the fund. The proposed rule appears to preclude the executive officers or directors of the general partner/managing member/investment manager of an investment fund from indirectly participating in IPO shares, that are purchased by the investment fund, through the management and performance fees of the general partner/managing member/investment manager of the investment fund (even though such indirect participation is permitted under FINRA Rule 5130). If this is the case, proposed Rule 5131(b) will preclude a FINRA member from allocating IPO shares to any investment fund that was, is, or may become an investment banking services client of the FINRA member within the Spinning Restricted Period because the investment fund would be deemed to be an "account" of each of the executive officers and directors.

In the similar situation of the treatment of portfolio managers under FINRA Rule 5130, FINRA members may not sell a "new issue" security to a portfolio manager as an individual, but such sales are permitted to the investment fund managed by the portfolio manager (and in which the portfolio manager may have a beneficial ownership interest, together with other restricted persons, up to 10%). We believe that the extension of the Account Definition to the investment fund itself is the result of FINRA's proposal to define an "account of an executive officer or director" based on the person's "financial interest" in and "discretion or control" over the account. Historically, FINRA has defined an account of a restricted person under FINRA Rule 5130 and the interest of a person in securities under FINRA Rule 5110 and NASD Rule 2720 in terms of the person's right to participate in the economic benefits of the account or securities

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functions…. Executive officers of subsidiaries may be deemed executive officers…if they perform such policy making functions…."

consistent with the beneficial ownership standards embodied in Section 16(a) of the Exchange Act.[11] The term "beneficial interest" in FINRA Rule 5130(i)(1) is defined as:

> "any economic interest, such as the right to share in gains or losses. The receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, shall not be considered a beneficial interest in the account."[12]

We believe that the better approach, based on FINRA's historical policy, would be for FINRA to revise the Account Definition to delete the term "discretion or control," replace the term "financial interest" with the term "beneficial interest," and define that term by reference to the definition in FINRA Rule 5130(i)(1).[13]

Regardless of whether FINRA amends the Revised Proposal to make the foregoing recommended changes to the Account Definition, we are concerned that it will be virtually impossible for a member to allocate IPO shares to any private investment fund under proposed FINRA Rule 5131(b) because of the difficulty in identifying, for each equity owner of the fund that is an executive officer or director of any company (or a materially supported person of such an executive officer or director), whether that company has an investment banking services relationship with the selling FINRA member that would trigger proposed FINRA Rule 5131(b).

The essence of the abuse that is identified with "spinning" is the intentional allocation of IPO shares to persons known to the member firm to be executive officers and directors of companies with whom the firm is doing or intends to do investment banking business. In the absence of intent, there is no harm. Executive officers and directors, their family members and accounts in which they have interests represent a strong source of funding for new public companies. The most effectively targeted rule would be one that prohibits member firms from intentionally allocating IPO shares to executive officers or directors of companies with which they do or intend to do investment banking business, either directly or indirectly through accounts beneficially owned by such executive officers and directors and their materially supported persons. A rule that requires a member firm to obtain information from investment funds in order to avoid inadvertently allocating IPO shares to a fund in which such an executive officer or director may have a beneficial interest is not effectively targeted.[14] For that reason, we believe that it is consistent with the purposes of the proposed "spinning" rule to revise either Rule 5131(b) or 5131(e)(1) to permit allocations to accounts in which an executive officer or

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[11] *See*, an explanation of the background of the NASD's determination to rely on the beneficial ownership standards in Section 16(a) in comparison to those in Section 13 in the ABA's comment letter to the NASD dated December 4, 2006, with respect to NASD Notice to Members 06-52, at 12 *et seq*.

[12] *See,* also, NASD Rule 2720(f)(2), which applies to both NASD Rule 2720 and FINRA Rule 5110.

[13] The recommended changes would also be consistent with the *Voluntary Initiative,* which defined an "account of an executive officer or director" in terms of the executive officer's or director's "beneficial ownership" of the account.

[14] We note that, even if a member firm were to obtain such information, relationships often change. The burden on a member firm to maintain constantly accurate records regarding such matters may be exceedingly difficult.

director may have an indirect financial interest if the member firm does not know, on the basis of information in its records, that such an executive officer or director has an interest in the account.

In the event FINRA is unable to adopt that change, it should make other changes to reduce the compliance burden associated with sales to investment funds. Experience with FINRA Rule 5130, which requires member firms selling IPO shares to obtain information from investment funds concerning whether more than 10% of their interests are beneficially owned by restricted persons, indicates that investment funds generally do not want to disclose the identities of their owners. As a result, it has become standard procedure, as permitted by Rule 5130, for fund managers to obtain information, using annual questionnaires, from fund investors about whether they are "restricted persons" pursuant to Rule 5130, and to provide the resulting information to their brokers on a no-names basis. For a number of reasons, creating a standard questionnaire with respect to the "spinning" prohibition will be much more difficult. To begin with, the rule does not permit questionnaires to be obtained annually. More importantly, the fund managers and their investors who are executive officers, directors and materially supported persons may not know whether a particular member firm has provided or intends to provide investment banking services to the company with which they or their supporting persons are associated.

It may, however, be possible to create a questionnaire for fund investors that will be effective in most cases if FINRA were to resolve an ambiguity in the definition. A member firm may allocate IPO shares to an investment fund if "executive officers, directors and materially supported persons collectively own interests representing no more than 25% of the assets of such fund." We believe that this should be read as meaning that the executive officers and directors of a <u>particular</u> company, and their materially supported persons, may collectively own no more than 25% of the fund. If so read on an individual-company basis (as opposed to being considered on an aggregate-company basis), the investment fund could distribute questionnaires among its owners asking whether they are executive officers or directors of companies or materially supported persons, with the names of the relevant companies and then total up the ownership interests of all persons associated with each company.[15] If the ownership interests for persons associated with any particular company exceeded 25%, the fund would have the option of disclosing the name of that company to the selling member or decline to purchase securities in the IPO. If, however, FINRA were to interpret the exception as meaning instead that the ownership interests of all persons associated as executive officer, director or materially supported person with all companies must be aggregated for purposes of the 25% test, then such a determination would be far more complicated and limiting, and the fund may feel the need to disclose the names of all such companies (however small the interest associated with each company) or decline to purchase from the IPO offering.

Accordingly, we believe that proposed FINRA Rule 5131(b) or Rule 5131(e)(1)(B) should contain a provision that would permit a FINRA member to rely, in good faith, on a representation of an account holder (or an authorized representative thereof) for 12 months that

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[15] This would be consistent with the determination of an "account of an executive officer or director" under the Voluntary Initiative.

no more than 25% of the assets of the account are owned by the executive officers or directors, or materially supported persons thereof, of any particular company that was, is or may become an investment banking services client of the FINRA member during the Spinning Restricted Period.[16] In addition, and also consistent with FINRA Rule 5130(b), the proposed rule should permit members to conduct an annual verification of an account's status through the use of negative consent letters whereby a member may furnish an investor with account information on record used to determine that the account is eligible to receive an allocation of IPO shares and ask the investor to indicate whether anything has changed to make the account ineligible for such an allocation; in the absence of any response from the investor, the member would be able to continue to deem the account eligible to receive allocations of IPO shares.[17] This has proved to be a workable procedure for several years with respect to compliance with FINRA Rule 5130.

As discussed above, because many investors in private investment funds may be executive officers and/or directors of a "company," whether public or private, the exemption/exception from the definition of "account of an executive officer or director" under proposed FINRA Rule 5131(e)(1)(B) may not have much practical utility unless the definition of "investment banking services" is subject to the Materiality Threshold we have recommended. In addition, we recommend that the Account Definition be revised to conform with the definition that was used in the *Voluntary Initiative*. Pursuant to Section 1(f) of the *Voluntary Initiative*, the term "account of an executive officer or director" encompassed an account that was beneficially owned "in whole or principal part" by the executive officer or director, where "in principal part" means at least 50% ownership. Because many FINRA members adopted procedures to ensure compliance with the *Voluntary Initiative*, it would be less disruptive to adopt a comparable standard under the proposed rule. Accordingly, we believe that the "spinning" prohibition with respect to an investment fund should be triggered at a 50% ownership level instead of 25%. We also suggest that ownership in an investment fund should be based on the "beneficial interest" of the executive officers and directors in the investment fund, as that term is defined in FINRA Rule 5130(i)(1), and not on the ownership of "assets" of the fund as proposed in the Account Definition, as this could result in difficult valuation issues.[18]

Finally, the general definition of "account of an executive officer or director" in proposed FINRA Rule 5131(e)(1) will trigger the "spinning" prohibition if an executive officer or director of a company, or a person materially supported thereby, has a "financial interest" in such account. Although FINRA Rule 5131(e)(1)(A) would exempt a financial interest in an investment company registered under the 1940 Act, the Revised Rule does not include a comparable exemption to FINRA Rule 5130(c)(6) for a foreign investment company that is not registered under the 1940 Act.[19] Further, a regulated insurance company or any publicly-traded

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[16] Without the proposed annual compliance procedure, FINRA members will be required to obtain such a representation immediately prior to each potential allocation of IPO shares, which is an unreasonable compliance burden.

[17] *See* NASD Notice to Members ("NTM") 03-79 under "Preconditions for Sale."

[18] The proposed "assets" calculation is another standard that departs from historical FINRA policy.

[19] Pursuant to FINRA Rule 5130(c)(6), an exemption from the application of FINRA Rule 5130 is available for an investment company organized under the laws of a foreign jurisdiction, provided that (A) the investment company is

company, for example, in which executive officers or directors, and/or materially supported persons thereof, own common shares of such company, even if a *de minimis* amount in the aggregate, would be precluded from receiving an allocation of IPO shares, even though the allocation is for the company/employer and not, individually, the executive officers, directors or materially supported persons thereof. Therefore, we believe that proposed Rule 5131(e)(1) should include exemptions comparable to those set forth in FINRA Rule 5130(c) for a financial interest in, among others, (i) a foreign investment company that is not registered under the 1940 Act, (ii) a common trust fund or similar fund, (iii) an insurance company general, separate or investment account, (iv) a publicly traded entity, (v) an Employee Retirement Income Security Act benefits plan, and (vi) a tax exempt charitable organization.

Delete the "Spinning" Prohibition from Proposed FINRA Rule 5131(b) and, Instead, Create a new Category of "Restricted Person" under FINRA Rule 5130: In view of our comments above suggesting that many of the provisions of proposed FINRA Rule 5131(b) be conformed to FINRA Rule 5130, and in light of the similarities in the purposes of proposed FINRA Rule 5131(b) (relating to "spinning") and FINRA Rule 5130 (relating to allocations of "new issues"),[20] it may be more efficient, and result in fewer adjustments to the compliance regimes of members, to delete proposed FINRA Rule 5131(b) in its entirety and, instead, create a new category of "restricted person" under FINRA Rule 5130. If FINRA were to elect this approach, it would not be sufficient to simply add a new category of "restricted person" to include any "executive officer or director of a company", including any materially supported person thereof. Rather, the new category of "restricted person" would also need to reflect our comments, above, with respect to the definitions of "investment banking services" and "account of an executive officer or director," and the new category should only apply to offerings that trade at a premium in the secondary market.

Proposal to Prohibit Investment Banking Services for 12 Months Following an IPO Allocation: The SEC requests comment on a proposal not submitted by FINRA. The SEC proposes to revise the "spinning" regulations proposed by FINRA in Rule 5131(b) to include a new provision that would prohibit members from seeking or providing investment banking services to a company for 12 months following any allocation of IPO shares to an account of an executive officer or director of the company (the "Proposed Sanction"). It appears that the SEC intends for the Proposed Sanction to prohibit a FINRA member from seeking investment banking business for 12 months from any company after the member has allocated IPO securities to any executive officer or director of a public or private company that was, is, or may become an investment banking services client of the member during the Spinning Restricted Period.

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listed on a foreign exchange for sale to the public or is authorized for sale to the public by a foreign regulatory authority or (B) no person owning more than 5% of the shares of the investment company is a restricted person, as defined in FINRA Rule 5130(i)(10).

[20] As set forth in NTM 03-79, FINRA Rule 5130 is "designed to protect the integrity of the public offering process by ensuring" that, among other things, "members do not withhold securities in a public offering [to]...use such securities to reward persons who are in a position to direct future business to members."

We are opposed to the Proposed Sanction, which would – by rule – impose an automatic sanction for even inadvertent allocations of IPO securities contrary to the Revised Proposal to an executive officer or director of a private or public company in circumstances where the "spinning" prohibition proposed by FINRA is significantly broad and difficult to comply with. Such a sanction would, in all cases, be financially disproportionate to the value of the securities involved in any violation, would not take into account the specific facts of each situation, deprive the FINRA member of its statutory right to a fair hearing before the imposition of any disciplinary sanction, and would unfairly deprive the company of the right to select the services of the FINRA member. In particular, as referenced, we believe that the Proposed Sanction would be contrary to Section 15A(a) of the Exchange Act, which requires that FINRA rules must provide a fair procedure for the disciplining of members and persons associated with members. Since the Proposed Sanction would be imposed without an opportunity for the FINRA member to obtain a fair hearing, we recommend that the SEC not further propose nor approve such an amendment to the proposed "spinning" regulation contained in the Revised Proposal.

Any sanctions that could be imposed by FINRA in connection with a violation of the proposed rule should be based upon, and determined solely from, the particular facts and circumstances giving rise to the violation, and should not be subject to automatic penalties, such as the Proposed Sanction. For example, an executive officer of a company that is a longstanding brokerage customer of a FINRA member receives an allocation of IPO securities from the member's corporate finance division upon effectiveness of the offering. However, at about the same time, a separate business division of the member (unaware of the allocation) enters into a formal engagement with the executive officer's company that contemplates the provision of investment banking services within the next three months. In such situation, the member may fail to identify the prior allocation of IPO shares to the executive officer of the company in sufficient time to cancel the allocation to the executive officer before the closing. Moreover, when this situation is identified, the member may conclude that it is legally obligated to comply with its obligations under both the purchase contract with the executive officer and the investment banking services contract. Alternatively, it may not always be clear if a company is a "current" investment banking client of a member at the time of an allocation of an IPO to an executive officer or director of such company when a member's services to the company have been intermittent and not always for compensation over a number of years. In each case, the imposition of a mandatory ban, as suggested by the SEC, would be an excessive penalty in light of the facts and circumstances underlying the potential violation of the proposed rule.

The Proposed Sanction provision should not in any event be approved without an opportunity for review of and comment on the text of the proposed rule. We request that the SEC republish for comment any proposal to adopt such a mandatory ban on investment banking services with a sixty-day comment period.

FINRA Should Clarify What Constitutes "Excessive" Compensation for the Purposes of Proposed FINRA Rule 5131(a): Pursuant to proposed FINRA Rule 5131(a), no member or associated person of a member may, among other things, offer IPO shares as consideration or inducement for the receipt of compensation that is "excessive" in relation to the services provided by the member. Because of the substantial uncertainty as to what might constitute "excessive" compensation for these purposes, we believe that there should be a presumption that

any services provided by a member for a "fair price," as contemplated by FINRA Rule 5110(a)(9) would not be deemed to be "excessive" for these purposes.[21] In addition, we believe that there should also be a presumption that any services provided by a member that are paid for in soft dollars in conformity with Section 28(e) of the Exchange Act and applicable interpretations by the SEC would not be deemed to be "excessive" for these purposes.

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The Committee appreciates the opportunity to comment on the Proposing Release. Members of the Committee are available to discuss our comments should the Commission or the staff so desire.

Very truly yours,

/s/ Jeffrey W. Rubin

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[21] Pursuant to FINRA Rule 5110(a)(9), the term "fair price" contemplates services in which the member has priced such services in good faith, on an arm's length, commercially reasonable basis, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar services.