SIFMA
Securities Industry and Financial Markets Association

April 8, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street
Washington, D.C. 20549-1090

Re: Release No. 34-61690; File No. SR-NASD-2003-140

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change, as modified by Amendment No. 3, Relating to the Prohibition of Certain Abuses in the Allocation of Distribution of Shares in Initial Public Offerings ("IPOs")

Dear Ms. Murphy:

The Capital Markets Committee (the "Committee") of the Securities Industry and Financial Markets Association[1] is pleased to respond to the Commission's request for comment to SR-NASD-2003-140 (the "Proposal"), as amended.

I. INTRODUCTION

In general, we continue to support the efforts of FINRA to address specific issues of concern in connection with the Initial Public Offering ("IPO") process, and are generally supportive of the proposed changes to the Proposal made by FINRA in Amendment No. 3. Consistent with previous comment,[2] the Committee continues to seek ways to improve the Proposal. In particular, the Committee is writing this letter to present certain proposals that seek to ensure uniform implementation of the Proposal by member firms, and that are sensitive to the high risk that member firms take when acting as underwriter in an IPO.

II. SPECIFIC COMMENT REGARDING THE PROPOSAL

2.1 The proposed provisions of FINRA Rule 5131(a) (prohibition on quid pro quo allocations) continues to reference "excessive" compensation.

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, bank and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information visit www.sifma.org.

[2] Please see the SIA Capital Markets Committee's February 2005 letter regarding the Proposal, currently available at: http://sec.gov/rules/sro/nyse/nyse200412/jfaulkner021504.pdf (the "SIA 2005 Letter"). The SIA Capital Markets Committee is one of the predecessor committees to the Committee.

The proposed rule prohibits any offers to allocate, or threats to withhold allocation of, shares allocated in an IPO in exchange for the receipt of compensation that is excessive in relation to the services provided to the customer by the member.

The Committee continues to support the Proposal's provisions regarding quid pro quo allocations. The Committee, however, continues to view the term "excessive" compensation as being subject to uncertainty. The Committee remains concerned that members may not be able to determine at what point compensation becomes excessive for purposes of the Proposal. The Committee appreciates the guidance provided in Amendment No. 3 to the Proposal, clarifying that an assessment of whether compensation is excessive will be based on all the relevant facts and circumstances, but feels strongly that language to that effect should be included in the rule when adopted.

Given the high level of risk and the competitiveness that characterizes the IPO market, the Committee is concerned that members may be criticized for good faith judgments regarding acceptable compensation levels. The Committee respectfully requests that the Proposal be amended to modify proposed Rule 5131(a), or alternatively to include additional Supplemental Material, to state that an assessment of whether compensation is excessive will be based upon 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 such services. The Committee believes that the language would be a helpful guide for members as they seek to comply with the proposed rule, and to FINRA when it examines for compliance by its members.

2.2 FINRA Rule 5131(b) (Restrictions on IPO allocations to investment banking clients) should be more carefully drafted to ensure consistent application.

The Proposal would prohibit a member or associated person thereof from allocating IPO securities to the account of an executive officer or director of a company (1) that is currently an investment banking client; (2) if in the 12-month period prior to the allocation the broker-dealer received compensation from the company for investment banking services; (3) if the member expects to provide or be retained for investment banking services in the three-month period following the allocation; or (4) on the condition that such executive officer or director, on behalf of the company, retain the member for performance of future investment banking services.

Amendment No. 3 to the Proposal (i) shortens from six to three months the period after an IPO allocation in which the member may not intend to provide or expect to be retained for investment banking services from the applicable company, (ii) removes the presumption that an IPO allocation made within six months prior to the receipt of investment banking business is made with the expectation or intent to receive such business, and (iii) adds Supplementary Material permitting issuer-directed allocations.

The Committee supports these changes; however, the Committee continues to be concerned regarding the implementation of proposed Rule 5131(b), in particular for accounts of persons who may be officers and directors of nonpublic companies. FINRA members would be required to implement policies, procedures and technology systems that determine and then cross-reference: (i) whether any given retail account – often among hundreds of thousands – is held on behalf of a

director or officer of any company; (ii) what constitutes a current client and how to identify such persons on a real-time basis; and (iii) when a person becomes one to which the member "intends to provide" investment banking services for purposes of the Proposal. The Committee believes that implementation and administration of these policies, procedures and systems will require significant resources, particularly for small firms, and may (notwithstanding the dedication of such resources) not fully achieve the appropriate purposes of the Proposal.

In response, the Committee respectfully requests the consideration of the following two suggestions to improve implementation and oversight of the Proposal.

First, most firms with retail business have established policies and procedures that remove the influence of investment banking personnel in IPO allocation. The Committee recommends an exception to proposed Rule 5131(b) for any ordinary course allocation made by private banking or private wealth management (or similar) personnel to directors and officers of nonpublic companies, provided that the firm maintains policies and procedures that are reasonably designed to prevent investment banking personnel from directing any allocation to any non-institutional client.

Second, the Committee respectfully recommends that FINRA clarify that each of the following will constitute compliance with proposed Rule 5131(b): (i) reliance on annual verification of an account's status through the use of negative consent letters; and (ii) establishment of policies and procedures that are reasonably designed to determine whether an entity is a current or prospective investment banking client, or whether the member firm intends to provide investment banking services to a prospective client, on the basis of reasonable criteria (which criteria may limit the identification of current clients to those relationships that are more than aspirational or passing, or for which the firm has a reasonable expectation of an active near-term relationship).

The Committee believes that these modifications would create a more objective basis for determination by members, would prevent overbroad prohibition on IPO investment, and will create an objective standard for FINRA when it examines for compliance by its members.

2.3 FINRA Rule 5131(d)(2)(B) (Requirements for lock-up agreements or other restrictions of the issuer's shares by officers and directors) should clarify that only IPO lock-ups are intended to be affected by this provision.

The proposed rule requires that any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer must provide that (1) such restrictions will apply to issuer-directed shares, and (2) at least two business days prior to the release of any lock-up provision, the lead manager will notify the issuer and make an announcement through a major news service, except where the release is effected solely to permit a transfer of securities not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms.

The Committee supports the provision, but would suggest adding clarifying language noting that the section's requirements apply only to lock-up agreements entered into in connection with the IPO, and not with respect to other lock-up agreements. The Committee believes that this is the intention

of the provision, but is concerned that the language of the Proposal, as drafted, may be read to apply more broadly.

Further, the Committee believes that in some cases the issuer, and not the member, may publish the required notice. The Committee suggests that the Proposal be clarified to note that the impending release or waiver may be announced by either the issuer or by the applicable member(s).

2.4 FINRA Rule 5131(d)(3) (Agreement Among Underwriters) should also permit members to sell returned shares in the market at market prices and to return the net profit from such sales to the issuer.

The proposed rule requires that the agreement among syndicate members provide that, to the extent not inconsistent with Regulation M, shares trading at a premium to the IPO price returned by a purchaser to a syndicate member after trading commences will be allotted to the syndicate short position, or, if no short position exists, the member must offer returned shares at the public offering price to unfilled customer orders pursuant to a random allocation methodology.

The Committee is concerned that the provision unnecessarily forces underwriters to reduce the syndicate short position regardless of market conditions. While the reduction of any outstanding syndicate short position may be the preferred course of action in a given situation, it may also be premature in other circumstances. The Committee therefore proposes that discretion remain with the syndicate to either reduce any syndicate short position or offer returned shares at the public offering price to unfilled customer orders. Further, the Committee also requests clarification that anonymous, ordinary course sales on a national securities exchange or ATS at market prices will be considered to be a random allocation for purposes of the Rule.[3]

Finally, the Committee believes that the appropriate time for determination of whether returned shares are trading at a premium to their IPO price is at the time such securities are returned, and seeks confirmation of that view.

2.5 FINRA Rule 5131(d)(4) – Market Orders

The proposed rule prohibits members from accepting a market order for the purchase of IPO shares prior to the commencement of secondary market trading in the applicable security.

The Committee supports the provision, but suggests clarifying that the prohibition applies to acceptance of a market order "for the purchase of shares in the secondary market that were, prior to the commencement of trading of such shares, subject of an IPO." The Committee believes that this formulation better captures the intention of FINRA to apply the prohibition to specific shares at a specific time.

[3] The Committee recognizes that in some situations concerns regarding the operation of Regulation M may cause a member to avoid such sales; in this regard, the Committee agrees with the March 2005 comment letter of the Committee on Federal Regulation of Securities (Business Law Section, American Bar Association) that FINRA should work together with the Commission and its Staff to provide that allocation of returned shares in compliance with FINRA rules would not constitute a distribution for purposes of Regulation M.

III. CONCLUSION

The Committee appreciates very much this opportunity to comment further on the Proposal. If you have any questions or require additional information, please do not hesitate to contact the undersigned at (212) 313-1118, or our counsel in this matter, Charles S. Gittleman and Russell D. Sacks of Shearman & Sterling LLP.

Sincerely,

Managing Director, Corporate Credit Markets Division
Securities Industry and Financial Markets Association

cc: Gary L. Goldsholle, Vice President and Associate General Counsel
Paul Mathews, Director, Corporate Financing Department
Joseph E. Price, Senior Vice President, Advertising Regulation/Corporate Financing
Thomas Selman, Executive Vice President, Regulatory Policy