



Public Offering Guide
Valuation of Securities in
Underwriting Compensation

September 2020

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OVERVIEW

FINRA's Public Offering System, which facilitates filings required under FINRA's Corporate Financing Rules (Rules 5110, 5121 and 2310), was updated to conform with the rule changes effective on September 16, 2020. The system updates simplify the valuation of securities acquired and beneficially owned by a participating member¹ during the review period².

The updates allow filers to disclose:

- acquisitions of securities beneficially owned by a participating member including securities that may be excluded from underwriting compensation³ pursuant to FINRA Rule 5110(d) or fall within one of the Principles-Based Approach transactions in Supplementary Material 5110.02, 5110.03 or 5110.04; and
- the value of securities acquired by participating members as underwriting compensation pursuant to FINRA Rule 5110(c).

The following sections provide general guidance on how to value securities acquisitions included as underwriting compensation pursuant to FINRA Rule 5110(c).

Please note when submitting an offering that contains securities acquired by a participating member, the Public Offering Filing System will require you to input the value for each acquisition of securities. This guide provides examples of the most common types of securities included as underwriting compensation.

CONTACT INFORMATION

For more information, contact FINRA's Corporate Financing Department at (240) 386-4623. If your questions relate to a specific filing, please contact the first reviewer assigned to the filing, otherwise please ask to speak with an analyst on the Public Offering Review staff.

¹ See FINRA Rule 5110(j)(15) for the definition of participating member.

² See FINRA Rule 5110(j)(20) for the definition of review period.

³ See FINRA Rule 5110(j)(22) for the definition of underwriting compensation.

VALUATION OF NON-CONVERTIBLE SECURITIES

Securities received or to be received by participating members that do not have an exercise or conversion price, typically common stock, are valued according to FINRA Rule 5110(c)(2).

The value of these securities can be further reduced, according to FINRA Rule 5110(c)(4), by extending the restriction on transfer beyond the 180-day lock-up period required by FINRA Rule 5110(e). For each additional 180-day period that the securities are restricted, the value will be reduced by 10 percent. Unlike warrants and other securities that have an exercise or conversion price, there is no limit on the valuation discount for non-convertible securities.

EXAMPLE OF A COMMON STOCK VALUATION

As an illustration, assume that there is a proposed public offering for \$100 million in offering proceeds, not including an overallotment option, comprised of 10,000,000 shares of common stock at \$10 per share. Participating members acquired 500,000 shares during the review period for a price per share of \$8.50.

Pursuant to FINRA Rule 5110(c)(2), the valuation should be:

(A) the difference between:

(i) either the market price per security on the date of acquisition, or, if no bona fide public market exists for the security, the public offering price per security; and

(ii) the per security cost;

$\$10 \text{ minus } \$8.50 \text{ equals } \mathbf{\$1.50}$

(B) multiplied by the number of securities received or to be received as underwriting compensation;

$\$1.50 \text{ multiplied by } 500,000 \text{ equals } \mathbf{\$750,000}$

(C) divided by the offering proceeds; and

\$750,000 divided by \$100,000,000 equals **0.0075**

(D) multiplied by one hundred.

0.0075 multiplied by 100 equals **0.75%**

The final result of 0.75% represents the value of the securities acquired by participating members that should be disclosed as underwriting compensation in the system in the "Compensation – Non-Cash" screen.

VALUATION OF CONVERTIBLE SECURITIES

Securities received or to be received by participating members that have an exercise or conversion price, such as warrants, are valued according to FINRA Rule 5110(c)(3).

The compensation value of a convertible security is the higher of the traditional valuation pursuant to FINRA Rule 5110(c)(3)(A) through (G) or the 0.2 percent scale valuation pursuant to FINRA 5110(c)(3)(H).

If the exercise price is greater than 125 percent of the public offering price, the 0.2 percent scale valuation is used to determine the convertible security value.

EXAMPLE OF A WARRANT VALUATION

As an illustration, assume that there is a proposed public offering for \$100 million in offering proceeds, not including an overallotment option, comprised of 10,000,000 shares of common stock at \$10 per share.

Participating members propose to receive a warrant to purchase 10% or 1,000,000 shares of the securities offered at an exercise price of \$12 per warrant (120% of the public offering price).

Pursuant to FINRA Rule 5110(c)(3), the valuation should be:

- (A) the public offering price per security multiplied by .65;

\$10 multiplied by .65 equals **\$6.50**

(B) minus the resultant of the exercise or conversion price per warrant less either:

(i) the market price per security on the date of acquisition, where a bona fide public market exists for the security; or

- (ii) the public offering price per security;

\$6.50 minus (\$12.00-\$10.00) equals **\$4.50**

(C) divided by two;

$\$4.50$ divided by 2 equals **$\$2.25$**

(D) multiplied by the number of securities underlying the warrants;

$\$2.25$ multiplied by 1,000,000 equals **$\$2,250,000$**

(E) less the total price paid for the warrants;

$\$2,250,000$ minus $\$0$ equals **$\$2,250,000$**

(F) divided by the offering proceeds; and

$\$2,250,000$ divided by $\$100,000,000$ equals **0.0225**

(G) multiplied by one hundred;

0.0225 multiplied by 100 equals **2.25%**

The final result of 2.25% represents the value of the securities acquired by participating members that should be disclosed as underwriting compensation in the system in the "Compensation – Non-Cash" screen.

OTHER TYPES OF SECURITIES

If participating members propose to acquire units or a unit purchase option, FINRA staff recommends that participating members and their counsel refer to the unit formula published in *Notice to Members 92-28*.

REFERENCES

- [Notice to Members 92-28](#)
- [Notice to Members 04-13](#)
- [Regulatory Notice 20-10](#)
- [FINRA Rule 5110](#)