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Required fields are shown with yellow backgrounds and asterisks.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2003 - * 140
Amendment No. (req. for Amendments *) 4

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal
☐	☑	☐

Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule

- ☐ 19b-4(f)(1)
- ☐ 19b-4(f)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Racquel Last Name * Russell

Title * Assistant General Counsel

E-mail * racquel.russell@finra.org

Telephone * (202) 728-8363 Fax (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 07/30/2010

By Gary L. Goldsholle
(Name *)

Vice President and Associate General Counsel
(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Gary Goldsholle,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information (required) Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change (required) Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") Amendment No. 4 to SR-NASD-2003-140, a proposed rule change to further and more specifically prohibit certain abuses in the allocation and distribution of shares in initial public offerings ("IPOs").

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on July 24, 2002, the Board of Directors of NASD Regulation, Inc. approved publication of a Notice to Members requesting comment on new Rule 2712 and authorized the filing of the proposed rule change with the SEC. The Board of Governors of FINRA (then known as NASD) approved publication and authorized filing the proposed rule change with the SEC at its meeting on July 25, 2002. In August 2002, FINRA issued Notice to Members 02-55.

At its meeting on November 12, 2003, the Board of Directors of NASD Regulation, Inc. approved publication of a subsequent Notice to Members requesting comment on amendments to new Rule 2712 and authorized the filing of the amendments to the proposed rule change with the SEC. In November 2003, FINRA issued Notice to

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[1] 15 U.S.C. 78s(b)(1).

Members 03-72. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no less than 90 and no more than 180 days following publication of the Regulatory Notice announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On February 10, 2010, FINRA filed with the SEC Amendment No. 3 to SR-NASD-2003-140, a proposed rule change to adopt new FINRA Rule 5131 (originally proposed as NASD Rule 2712) to further and more specifically prohibit certain abuses in the allocation and distribution of shares in IPOs. The SEC published the proposed rule change for notice and comment on March 18, 2010[2] and received three comment letters.[3]

FINRA is filing this Amendment No. 4 to respond to the comment letters received and to propose amendments in response to such comments, as appropriate. Amendment No. 4 provides for changes that, among other things, revise the spinning provisions,

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2 See Securities Exchange Act Release No. 61690 (March 11, 2010), 75 FR 13176 (March 18, 2010) ("Amendment No. 3").

3 See Letter from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, Business Law Section, American Bar Association ("ABA"), to Elizabeth M. Murphy, Secretary, SEC, dated April 6, 2010; Letter from Sean Davy, Managing Director, Corporate Credit Markets Division, Securities Industry Financial Markets Association ("SIFMA"), to Elizabeth M. Murphy, Secretary, SEC, dated April 8, 2010; and Letter from Ross M. Langill, Chairman & CEO, Regal Bay Investment Group LLC ("Regal"), to Elizabeth M. Murphy, Secretary, SEC, dated April 8, 2010.

provide members with additional flexibility in handling returned shares, clarify the scope of the lock-up disclosure provision and propose several new defined terms.

Prohibition on Spinning

Proposed FINRA Rule 5131(b) prohibits the allocation of IPO shares to the account of an executive officer or director of a company (1) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months; (2) if the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or (3) on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.

Commenters generally supported the proposed changes to the spinning rule but requested additional modifications.[4] Commenters' concerns included that it would be difficult to identify the universe of officers and directors subject to the rule and asked that members be permitted to rely on annual negative consent letters.[5] One commenter expressed particular concern regarding the applicability of the rule to officers and directors of non-public companies.[6]

In response to commenters' concerns, FINRA is proposing several changes to the spinning provisions. First, FINRA proposes that members establish, maintain and enforce policies and procedures reasonably designed to ensure that investment banking

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4 See SIFMA.

5 See ABA and SIFMA.

6 See SIFMA.

personnel have no involvement or influence, directly or indirectly, in the new issue allocation decisions of the member. FINRA believes that such procedures are essential to managing conflicts of interest between investment banking and syndicate activities. We understand that these procedures are customary at members today, and we want to ensure that such policies and procedures remain in force.

In addition, in response to comments, FINRA proposes to narrow the scope of the non-public companies covered by the spinning provisions to focus the rule and firms' compliance efforts on those allocations that have the greatest potential for abuse. Specifically, the spinning provisions would apply to any account in which an executive officer or director of a public company or a "covered non-public company," or a person materially supported by such executive officer or director, has a beneficial interest. The term "covered non-public company" means any non-public company satisfying the following criteria: (i) income of at least $1 million in the last fiscal year or in two of the last three fiscal years and shareholders' equity of at least $15 million; (ii) shareholders' equity of at least $30 million and a two-year operating history; or (iii) total assets and total revenue of at least $75 million in the latest fiscal year or in two of the last three fiscal years.[7]

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[7] These criteria are based on quantitative initial listing standards for a national securities exchange, which is a suitable proxy for the types of companies that are likely to be targeted by members for investment banking services. In this case, we have determined that the applicable standards should be no less than those required for initial listing on the NASDAQ Global Market. FINRA further believes that, in modifying the scope of companies covered by the spinning provisions, it is unnecessary to create a de minimis standard for investment banking services compensation as urged by the ABA. Moreover, a de minimis standard would pose additional compliance burdens and would be susceptible to abuse by those seeking to avoid application of the proposed rule.

One commenter stated that it may be difficult to determine when the member "intends to provide" investment banking services and asked that the member be permitted to rely on policies and procedures reasonably designed to determine whether an entity is a current or prospective investment banking client, or whether the member 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).[8] We do not believe that the spinning provisions should be recast solely as a "policies and procedures" rule. However, in response to commenters' concerns and in light of the provision explicitly requiring policies and procedures excluding investment banking personnel input into new issue allocation decisions, FINRA proposes to modify the three month forward-looking provision to prohibit new issue allocations only where the person responsible for making the allocation decision "knows or has reason to know that the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months." We believe that this change strikes an appropriate balance in addressing the potential that new issue allocations will influence future business with the member while not unnecessarily impacting the capital formation process.[9] However, if a member

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8 See SIFMA.

9 If an executive officer or director receives an allocation and the investment bank subsequently is retained for the performance of investment banking services within the three month window by such executive officer or director's employing firm, FINRA will investigate the particular information about the business relationship that was known (and by whom) at the time of the allocation, including a review of the communications between the broker-dealer and the

maintains effective information barriers between the investment banking and syndicate departments and the persons responsible for making new issue allocation decisions neither know nor have reason to know of the prospective business relationship, the forward-looking provision will not be violated.

To facilitate compliance with the spinning provisions as requested by commenters, proposed new Supplementary Material .02 expressly permits members to rely on written representations obtained within the prior 12 months from the beneficial owner(s) of the account (or a person authorized to represent the beneficial owner(s)) as to whether such beneficial owner(s) is an executive officer or director (or person materially supported by an executive officer or director) and if so, the company(ies) on whose behalf such executive officer or director serves. Consistent with current practice under FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), FINRA requires that the initial representation be an affirmative representation, but will permit such representation to be updated annually through the use of negative consent letters. Members are reminded that a member may not rely upon any representation it believes, or has reason to believe, is inaccurate. Finally, a member would be required to maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue for at least three years following the member's allocation to that account.

Members should understand that the representation in the spinning context differs from that in FINRA Rule 5130 because, in the spinning case, the information obtained

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investment banking client, and between the investment banking and syndicate departments, as well as the member's systems for logging and managing prospective and current client and transaction information.

from the customer is not, by itself, sufficient to make a determination of whether a customer is eligible to purchase a new issue. Under FINRA Rule 5131, a person is restricted with respect to all new issues. In the spinning context, whether an account of an executive officer or director (or materially supported person) will be eligible to purchase a new issue also will depend upon whether the company pertaining to such executive officer or director is a current or prospective client of the firm as set forth in paragraph (b). Members may choose to adopt a more restrictive internal policy prohibiting allocations to all executive officers, directors and materially supported persons; however this is not required under the proposed rule change.[10]

Commenters also asked that the definition of "account of an executive officer or director" be amended to apply to accounts in which an executive officer, director or materially supported person has a "beneficial interest" rather than a "financial interest."[11] Commenters asked that the rule exclude accounts over which executive officers, directors or materially supported persons have "discretion or control" as this may unduly impact allocations to certain funds.[12] Commenters further argued that the definition of "account

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10 FINRA notes that the Voluntary Initiative more broadly prohibited allocations to the account of any executive officer or director of a U.S. public company or a public company for which a U.S. market is the principal equity trading market with respect to all hot IPOs. Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors, http://www.sec.gov/news/press/globalvolinit.htm (Apr. 28, 2003).

11 See ABA. Commenters generally favored the use of defined terms in proposed FINRA Rule 5131 that are consistent with the terms used in FINRA Rule 5130 to facilitate compliance among the rules and, wherever possible, to have consistent exceptions with respect to offerings. See ABA and Regal.

12 See ABA.

of an executive officer or director" should be modified to exclude certain other entities (such as foreign investment companies) consistent with FINRA Rule 5130(c).[13]

In response to comments, FINRA proposes to delete the definition of "account of an executive officer or director" and to instead include a new limitation in the spinning rule providing that the spinning prohibitions would not apply to allocations made to any account described in FINRA Rule 5130(c)(1) through (3) and (5) through (10), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.[14] As requested by commenters, FINRA also proposes to add a new definition of "beneficial interest," which will have the same meaning as FINRA Rule 5130.[15] We believe deleting the term "account of an executive officer or director" and modifying the scope of the rule to generally exclude those accounts excepted from FINRA Rule 5130(c) is appropriate in that allocations to such accounts are not likely to result in the type of abuse the spinning prohibition is geared toward. FINRA believes that the proposal, as amended, continues to meet the goals of the rule while avoiding an unnecessary impact on capital formation. In addition, by

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13 See ABA.

14 One commenter asked that hedge funds clearly be included in the proposal. See Regal. FINRA notes that hedge funds would be included where the beneficial interest of executive officers and directors of a particular company (and materially supported persons) in the aggregate exceed 25%. FINRA continues to believe that the 25% threshold is most appropriate and therefore will not increase the standard to 50% as requested by one commenter. See ABA.

15 FINRA Rule 5130(i)(1) defines "beneficial interest" to mean 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.

replacing references to "financial interest" with "beneficial interest" and deleting the reference to accounts in which officers and directors exercise "discretion or control," FINRA believes that the rule more properly focuses on accounts in which relevant parties have an economic interest.

Commenters argued that the spinning rule should apply only to "hot IPOs" and should exclude the types of offerings excepted under FINRA Rule 5130(i)(9).[16] We do not agree that the rule should apply only to "hot IPOs." FINRA believes that the proposed rule change should not be limited to hot IPOs for the same reasons that FINRA Rule 5130 is not limited to hot IPOs.[17] Specifically, the operation of a rule based on an unknown future event – the opening price – creates compliance difficulties and potentially may exacerbate spinning problems and may harm capital formation by necessitating members to cancel allocations and reallocate shares to another customer. We do, however, agree that certain types of offerings not likely to trade at a premium in the aftermarket should be excluded from the rule. Therefore, we propose to replace the defined term "initial public offering" or "IPO" with the term "new issue" throughout the proposed rule and to use the same definition provided in FINRA Rule 5130(i)(9). In developing the definition of "new issue" in FINRA Rule 5130, FINRA carefully

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16 See ABA.

17 While earlier proposed versions of FINRA Rule 5130 would have applied only to "hot issues," FINRA, then NASD, revised the proposal to cover the purchase and sale of all initial equity public offerings, not just those that open above a designated premium, because FINRA believed the revised approach would be easier to understand and would avoid many of the complexities associated with the cancellation provision. See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126 (October 31, 2003) (Order Approving File No. SR-NASD-99-60). (Proposed rule change relating to restrictions on the purchases and sales of initial public offerings of equity securities).

considered the extent to which such offerings may be hot issues. Thus, the proposed rule, as amended, applies to "new issues," meaning "any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular." As is the case in FINRA Rule 5130, the proposed definition of "new issue" excludes:

- Offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act of 1933 ("Securities Act"), or Securities Act Rule 504 if the securities are "restricted securities" under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;
- Offerings of exempted securities as defined in Section 3(a)(12) of the Exchange Act, and rules promulgated thereunder;
- Offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;
- Rights offerings, exchange offers, or offerings made pursuant to a merger or acquisition;
- Offerings of investment grade asset-backed securities;
- Offerings of convertible securities;
- Offerings of preferred securities;
- Offerings of an investment company registered under the Investment Company Act of 1940 (Investment Company Act");
- Offerings of securities (in ordinary share form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States; and

- Offerings of a business development company as defined in Section 2(a)(48) of the Investment Company Act, a direct participation program as defined in Rule 2310(a) or a real estate investment trust as defined in Section 856 of the Internal Revenue Code.

IPO Pricing and Trading Practices

Commenters generally supported the amended proposal related to IPO Pricing and Trading Practices.[18] However, one commenter asked that FINRA include clarifying language that the lock-up provision would only apply to lock-ups entered into in connection with the IPO, and not with respect to other lock-up agreements.[19] We confirm that this provision applies only to lock-up agreements entered into in connection with a new issue and have modified the rule text to reflect this.[20] This commenter also asked that FINRA clarify that the required notice of an impending release or waiver of a lock-up may be announced either by the issuer or the applicable member(s).[21] We agree that, so long as the announcement is made through a major news service at least two days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the requirement is satisfied irrespective of whether such announcement is made by the book-running lead manager, another member or by the issuer. Thus, FINRA is proposing new Supplementary Material .03 in response to comments to provide that the

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18 See SIFMA.

19 See SIFMA.

20 Proposed Rule 5131(d)(2), as amended, provides that "[a]ny lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer entered into in connection with a new issue shall provide that . . ." (new language emphasized).

21 See SIFMA.

required announcement also may be made by another member or the issuer. However, we note that it remains the responsibility of the book-running lead manager to ensure that the impending release or waiver is properly announced in compliance with this rule.

One commenter argued that the rule should be changed to permit the syndicate to retain discretion to either use returned shares to reduce the syndicate position or toward unfilled customer orders.[22] FINRA does not agree that this change is appropriate. FINRA expects that when shares trade at a premium to the public offering price, the incidence of returned shares should be minimal so as not to affect the ability of syndicate members to stabilize the market for such shares to the extent stabilization activities are even necessary. Further, the complexity of addressing this alternative would unnecessarily complicate the proposed rule change.[23] However, in response to comments, FINRA is amending the rule to provide members with additional flexibility in the handling of returned shares. The amended proposal continues to require that, to the extent not inconsistent with SEC Regulation M, the agreement between the book-running lead manager and other syndicate members must require that any shares trading at a premium to the public offering price returned by a purchaser to a syndicate member after

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22 See SIFMA.

23 SIFMA also asked FINRA to clarify that anonymous, ordinary course sales on a national securities exchange or ATS at market prices will be considered a "random allocation" for the purposes of the rule. FINRA disagrees. The provision, as previously proposed would have required that, where no syndicate short position exists, the member must offer the returned shares to unfilled customer orders at the public offering price, not the market price. Moreover, if the shares are trading at a premium to the public offering price, then sales by the member at market prices would result in the premium inuring to the benefit of the member, which is inconsistent with the purpose of the provision and a member's obligations under FINRA Rule 5130.

secondary market trading commences be used to offset the existing syndicate short position.[24] However, where no syndicate short position exists, the proposed rule change would provide the member with the option, provided that it is in accordance with SEC Regulation M, to either: (1) offer returned shares at the public offering price to unfilled customers' orders pursuant to a random allocation methodology or (2) sell returned shares on the secondary market and donate profits from the sale to an "unaffiliated charitable organization" with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member.[25] Proposed FINRA Rule 5131 establishes a new definition of "unaffiliated charitable organization" to prevent such charitable donations from benefitting the member or executive officers and directors of the member (and persons they materially support). FINRA believes that charitable donations funded by returned shares should not provide any reputational benefit to the member. The definition of "unaffiliated charitable organization" is closely tied to specific information charities are required to file with the Internal Revenue Service.

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24 One commenter asked for confirmation that the appropriate time for determining whether returned shares are trading at a premium to their IPO price is at the time such securities are returned. We agree. See SIFMA. Another commenter argued that the requirement that members use a random allocation methodology to reallocate returned shares was inadequate. See Regal. We disagree and note that this standard is already used successfully in other FINRA rules. See FINRA Rule 2360 (Allocation of Exercise Assignment Notices).

25 Proposed FINRA Rule 5131(e)(9) defines "unaffiliated charitable organization" as a tax-exempt entity organized under Section 501(c)(3) of the Internal Revenue Code that is not affiliated with the member and for which no executive officer or director of the member, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (i.e., officers, directors, trustees, key employees, highest compensated employees and certain independent contractors).

Members that choose this alternative must be able to demonstrate that their charitable donation was made in accordance with this rule.

The proposed rule change, as amended, prohibits the acceptance of market orders for the purchase of IPO shares prior to the commencement of trading on the secondary market. A commenter supported the proposed amendment but offered alternative rule text.[26] FINRA favors its existing rule text but proposes a slight modification in response to comments to further clarify the provision such that the relevant text will now state that "no member may accept a market order for the purchase of shares of a new issue in the secondary market prior to the commencement of trading of such shares in the secondary market."

Other Issues

Commenters reiterated certain concerns regarding FINRA's proposed provision relating to abusive allocation arrangements. Proposed FINRA Rule 5131(a) prohibits a member from offering or threatening to withhold shares it allocates in an IPO as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member (i.e., quid pro quo allocations). Commenters generally supported this proposed provision but reiterated earlier concerns that the term "excessive" is subject to uncertainty.[27] One commenter requested that FINRA clarify that any services provided for a "fair price" as provided by FINRA's Corporate Financing Rule (FINRA Rule 5110(a)(9)) would not be deemed excessive.[28] This commenter also

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26 See SIFMA.

27 See ABA and SIFMA.

28 See ABA.

requested guidance that any services provided by a member paid for using "soft dollars" in conformity with Section 28(e) of the Exchange Act also would not be deemed excessive.[29] Another commenter asked that clarifying language be added to the rule to provide that an assessment of whether compensation is excessive would be based on 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.[30]

As stated in Amendment No. 3, FINRA agrees that an assessment of whether or not compensation is excessive would 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.[31] However, FINRA continues to believe that the proposed language, which refers to "compensation that is excessive in relation to the services provided," is most appropriate in that it affords FINRA the necessary flexibility in addressing the range of potential quid pro quo arrangements that may arise. As stated in Amendment No. 3, we do not believe it is necessary to include rule text stating that an assessment of whether compensation is "excessive" will be based upon all of the relevant facts and circumstances.[32] Likewise, we do not believe it is appropriate to provide blanket guidance regarding payments made in conformity with Section 28(e) of the Exchange Act or FINRA Rule 5110(a)(9).

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29 See ABA.

30 See SIFMA.

31 See Amendment No. 3.

32 See Amendment No. 3.

Finally, one commenter raised concerns regarding FINRA's proposed flipping provision.[33] This commenter argued that, instead of defining the flipping period to mean the initial sale of new issue shares within 30 days following the offering date, the flipping provision should be based on the sale of shares prior to the book manager lifting the penalty bid, making the time period under the rule subject to the discretion of the managing underwriter.[34] FINRA does not agree that the suggested alternative represents an improvement to the proposed provision. FINRA believes that the certainty and finality of the proposed approach, including the 30-day window, is the appropriate duration for prohibiting members from recouping commissions from associated persons whose customers sell in cases where a penalty bid has not been assessed on the entire syndicate.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no less than 90 and no more than 180 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[35] which require, 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.

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33 See Regal.

34 See Regal.

35 15 U.S.C. 78o–3(b)(6).

FINRA believes that the new, specifically targeted provisions in the proposed rule change will aid member compliance efforts and help to maintain investor confidence in the capital markets.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The SEC received three comment letters in response to Amendment No. 3 to the proposed rule change.[36] FINRA's response to comments is discussed in Section 3 above.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[37]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

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36 See note 3 supra.

37 15 U.S.C. 78s(b)(2).

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 4. Text of the proposed rule change marked to show additions to and deletions from changes proposed by Amendment No. 3 to the filing.

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2003-140)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to the Prohibition of Certain Abuses in the Allocation and Distribution of Shares in Initial Public Offerings ("IPOs")

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on September 15, 2003, 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") and amended on December 9, 2003, August 4, 2004, February 17, 2010, and July 30, 2010, the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing Amendment No. 4 to SR-NASD-2003-140, a proposed rule change to further and more specifically prohibit certain abuses in the allocation and distribution of shares in initial public offerings ("IPOs").

The text of the proposed rule change is available on FINRA's Web site at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On February 10, 2010, FINRA filed with the SEC Amendment No. 3 to SR-NASD-2003-140, a proposed rule change to adopt new FINRA Rule 5131 (originally proposed as NASD Rule 2712) to further and more specifically prohibit certain abuses in the allocation and distribution of shares in IPOs. The SEC published the proposed rule change for notice and comment on March 18, 2010[3] and received three comment letters.[4]

FINRA is filing this Amendment No. 4 to respond to the comment letters received and to propose amendments in response to such comments, as appropriate. Amendment No. 4 provides for changes that, among other things, revise the spinning provisions,

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3 See Securities Exchange Act Release No. 61690 (March 11, 2010), 75 FR 13176 (March 18, 2010) ("Amendment No. 3").

4 See Letter from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, Business Law Section, American Bar Association ("ABA"), to Elizabeth M. Murphy, Secretary, SEC, dated April 6, 2010; Letter from Sean Davy, Managing Director, Corporate Credit Markets Division, Securities Industry Financial Markets Association ("SIFMA"), to Elizabeth M. Murphy, Secretary, SEC, dated April 8, 2010; and Letter from Ross M. Langill, Chairman & CEO, Regal Bay Investment Group LLC ("Regal"), to Elizabeth M. Murphy, Secretary, SEC, dated April 8, 2010.

provide members with additional flexibility in handling returned shares, clarify the scope of the lock-up disclosure provision and propose several new defined terms.

Prohibition on Spinning

Proposed FINRA Rule 5131(b) prohibits the allocation of IPO shares to the account of an executive officer or director of a company (1) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months; (2) if the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or (3) on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.

Commenters generally supported the proposed changes to the spinning rule but requested additional modifications.[5] Commenters' concerns included that it would be difficult to identify the universe of officers and directors subject to the rule and asked that members be permitted to rely on annual negative consent letters.[6] One commenter expressed particular concern regarding the applicability of the rule to officers and directors of non-public companies.[7]

In response to commenters' concerns, FINRA is proposing several changes to the spinning provisions. First, FINRA proposes that members establish, maintain and enforce policies and procedures reasonably designed to ensure that investment banking

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5 See SIFMA.

6 See ABA and SIFMA.

7 See SIFMA.

personnel have no involvement or influence, directly or indirectly, in the new issue allocation decisions of the member. FINRA believes that such procedures are essential to managing conflicts of interest between investment banking and syndicate activities. We understand that these procedures are customary at members today, and we want to ensure that such policies and procedures remain in force.

In addition, in response to comments, FINRA proposes to narrow the scope of the non-public companies covered by the spinning provisions to focus the rule and firms' compliance efforts on those allocations that have the greatest potential for abuse. Specifically, the spinning provisions would apply to any account in which an executive officer or director of a public company or a "covered non-public company," or a person materially supported by such executive officer or director, has a beneficial interest. The term "covered non-public company" means any non-public company satisfying the following criteria: (i) income of at least $1 million in the last fiscal year or in two of the last three fiscal years and shareholders' equity of at least $15 million; (ii) shareholders' equity of at least $30 million and a two-year operating history; or (iii) total assets and total revenue of at least $75 million in the latest fiscal year or in two of the last three fiscal years.[8]

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[8] These criteria are based on quantitative initial listing standards for a national securities exchange, which is a suitable proxy for the types of companies that are likely to be targeted by members for investment banking services. In this case, we have determined that the applicable standards should be no less than those required for initial listing on the NASDAQ Global Market. FINRA further believes that, in modifying the scope of companies covered by the spinning provisions, it is unnecessary to create a de minimis standard for investment banking services compensation as urged by the ABA. Moreover, a de minimis standard would pose additional compliance burdens and would be susceptible to abuse by those seeking to avoid application of the proposed rule.

One commenter stated that it may be difficult to determine when the member "intends to provide" investment banking services and asked that the member be permitted to rely on policies and procedures reasonably designed to determine whether an entity is a current or prospective investment banking client, or whether the member 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).[9] We do not believe that the spinning provisions should be recast solely as a "policies and procedures" rule. However, in response to commenters' concerns and in light of the provision explicitly requiring policies and procedures excluding investment banking personnel input into new issue allocation decisions, FINRA proposes to modify the three month forward-looking provision to prohibit new issue allocations only where the person responsible for making the allocation decision "knows or has reason to know that the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months." We believe that this change strikes an appropriate balance in addressing the potential that new issue allocations will influence future business with the member while not unnecessarily impacting the capital formation process.[10] However, if a member

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9 See SIFMA.

10 If an executive officer or director receives an allocation and the investment bank subsequently is retained for the performance of investment banking services within the three month window by such executive officer or director's employing firm, FINRA will investigate the particular information about the business relationship that was known (and by whom) at the time of the allocation, including a review of the communications between the broker-dealer and the investment banking client, and between the investment banking and syndicate

maintains effective information barriers between the investment banking and syndicate departments and the persons responsible for making new issue allocation decisions neither know nor have reason to know of the prospective business relationship, the forward-looking provision will not be violated.

To facilitate compliance with the spinning provisions as requested by commenters, proposed new Supplementary Material .02 expressly permits members to rely on written representations obtained within the prior 12 months from the beneficial owner(s) of the account (or a person authorized to represent the beneficial owner(s)) as to whether such beneficial owner(s) is an executive officer or director (or person materially supported by an executive officer or director) and if so, the company(ies) on whose behalf such executive officer or director serves. Consistent with current practice under FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), FINRA requires that the initial representation be an affirmative representation, but will permit such representation to be updated annually through the use of negative consent letters. Members are reminded that a member may not rely upon any representation it believes, or has reason to believe, is inaccurate. Finally, a member would be required to maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue for at least three years following the member's allocation to that account.

Members should understand that the representation in the spinning context differs from that in FINRA Rule 5130 because, in the spinning case, the information obtained from the customer is not, by itself, sufficient to make a determination of whether a

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departments, as well as the member's systems for logging and managing prospective and current client and transaction information.

customer is eligible to purchase a new issue. Under FINRA Rule 5131, a person is restricted with respect to all new issues. In the spinning context, whether an account of an executive officer or director (or materially supported person) will be eligible to purchase a new issue also will depend upon whether the company pertaining to such executive officer or director is a current or prospective client of the firm as set forth in paragraph (b). Members may choose to adopt a more restrictive internal policy prohibiting allocations to all executive officers, directors and materially supported persons; however this is not required under the proposed rule change.[11]

Commenters also asked that the definition of "account of an executive officer or director" be amended to apply to accounts in which an executive officer, director or materially supported person has a "beneficial interest" rather than a "financial interest."[12] Commenters asked that the rule exclude accounts over which executive officers, directors or materially supported persons have "discretion or control" as this may unduly impact allocations to certain funds.[13] Commenters further argued that the definition of "account

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[11] FINRA notes that the Voluntary Initiative more broadly prohibited allocations to the account of any executive officer or director of a U.S. public company or a public company for which a U.S. market is the principal equity trading market with respect to all hot IPOs. Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors, http://www.sec.gov/news/press/globalvolinit.htm (Apr. 28, 2003).

[12] See ABA. Commenters generally favored the use of defined terms in proposed FINRA Rule 5131 that are consistent with the terms used in FINRA Rule 5130 to facilitate compliance among the rules and, wherever possible, to have consistent exceptions with respect to offerings. See ABA and Regal.

[13] See ABA.

of an executive officer or director" should be modified to exclude certain other entities (such as foreign investment companies) consistent with FINRA Rule 5130(c).[14]

In response to comments, FINRA proposes to delete the definition of "account of an executive officer or director" and to instead include a new limitation in the spinning rule providing that the spinning prohibitions would not apply to allocations made to any account described in FINRA Rule 5130(c)(1) through (3) and (5) through (10), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.[15] As requested by commenters, FINRA also proposes to add a new definition of "beneficial interest," which will have the same meaning as FINRA Rule 5130.[16] We believe deleting the term "account of an executive officer or director" and modifying the scope of the rule to generally exclude those accounts excepted from FINRA Rule 5130(c) is appropriate in that allocations to such accounts are not likely to result in the type of abuse the spinning prohibition is geared toward. FINRA believes that the proposal, as amended, continues to meet the goals of

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14 See ABA.

15 One commenter asked that hedge funds clearly be included in the proposal. See Regal. FINRA notes that hedge funds would be included where the beneficial interest of executive officers and directors of a particular company (and materially supported persons) in the aggregate exceed 25%. FINRA continues to believe that the 25% threshold is most appropriate and therefore will not increase the standard to 50% as requested by one commenter. See ABA.

16 FINRA Rule 5130(i)(1) defines "beneficial interest" to mean 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.

the rule while avoiding an unnecessary impact on capital formation. In addition, by replacing references to "financial interest" with "beneficial interest" and deleting the reference to accounts in which officers and directors exercise "discretion or control," FINRA believes that the rule more properly focuses on accounts in which relevant parties have an economic interest.

Commenters argued that the spinning rule should apply only to "hot IPOs" and should exclude the types of offerings excepted under FINRA Rule 5130(i)(9).[17] We do not agree that the rule should apply only to "hot IPOs." FINRA believes that the proposed rule change should not be limited to hot IPOs for the same reasons that FINRA Rule 5130 is not limited to hot IPOs.[18] Specifically, the operation of a rule based on an unknown future event – the opening price – creates compliance difficulties and potentially may exacerbate spinning problems and may harm capital formation by necessitating members to cancel allocations and reallocate shares to another customer. We do, however, agree that certain types of offerings not likely to trade at a premium in the aftermarket should be excluded from the rule. Therefore, we propose to replace the defined term "initial public offering" or "IPO" with the term "new issue" throughout the proposed rule and to use the same definition provided in FINRA Rule 5130(i)(9). In

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17 See ABA.

18 While earlier proposed versions of FINRA Rule 5130 would have applied only to "hot issues," FINRA, then NASD, revised the proposal to cover the purchase and sale of all initial equity public offerings, not just those that open above a designated premium, because FINRA believed the revised approach would be easier to understand and would avoid many of the complexities associated with the cancellation provision. See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126 (October 31, 2003) (Order Approving File No. SR-NASD-99-60). (Proposed rule change relating to restrictions on the purchases and sales of initial public offerings of equity securities).

developing the definition of “new issue” in FINRA Rule 5130, FINRA carefully considered the extent to which such offerings may be hot issues. Thus, the proposed rule, as amended, applies to “new issues,” meaning “any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular.” As is the case in FINRA Rule 5130, the proposed definition of “new issue” excludes:

- Offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act of 1933 (“Securities Act”), or Securities Act Rule 504 if the securities are "restricted securities" under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;
- Offerings of exempted securities as defined in Section 3(a)(12) of the Exchange Act, and rules promulgated thereunder;
- Offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;
- Rights offerings, exchange offers, or offerings made pursuant to a merger or acquisition;
- Offerings of investment grade asset-backed securities;
- Offerings of convertible securities;
- Offerings of preferred securities;
- Offerings of an investment company registered under the Investment Company Act of 1940 (Investment Company Act”);
- Offerings of securities (in ordinary share form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States; and

- Offerings of a business development company as defined in Section 2(a)(48) of the Investment Company Act, a direct participation program as defined in Rule 2310(a) or a real estate investment trust as defined in Section 856 of the Internal Revenue Code.

IPO Pricing and Trading Practices

Commenters generally supported the amended proposal related to IPO Pricing and Trading Practices.[19] However, one commenter asked that FINRA include clarifying language that the lock-up provision would only apply to lock-ups entered into in connection with the IPO, and not with respect to other lock-up agreements.[20] We confirm that this provision applies only to lock-up agreements entered into in connection with a new issue and have modified the rule text to reflect this.[21] This commenter also asked that FINRA clarify that the required notice of an impending release or waiver of a lock-up may be announced either by the issuer or the applicable member(s).[22] We agree that, so long as the announcement is made through a major news service at least two days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the requirement is satisfied irrespective of whether such announcement is made by the book-running lead manager, another member or by the issuer. Thus, FINRA

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19 See SIFMA.

20 See SIFMA.

21 Proposed Rule 5131(d)(2), as amended, provides that "[a]ny lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer entered into in connection with a new issue shall provide that . . ." (new language emphasized).

22 See SIFMA.

is proposing new Supplementary Material .03 in response to comments to provide that the required announcement also may be made by another member or the issuer. However, we note that it remains the responsibility of the book-running lead manager to ensure that the impending release or waiver is properly announced in compliance with this rule.

One commenter argued that the rule should be changed to permit the syndicate to retain discretion to either use returned shares to reduce the syndicate position or toward unfilled customer orders.[23] FINRA does not agree that this change is appropriate. FINRA expects that when shares trade at a premium to the public offering price, the incidence of returned shares should be minimal so as not to affect the ability of syndicate members to stabilize the market for such shares to the extent stabilization activities are even necessary. Further, the complexity of addressing this alternative would unnecessarily complicate the proposed rule change.[24] However, in response to comments, FINRA is amending the rule to provide members with additional flexibility in the handling of returned shares. The amended proposal continues to require that, to the extent not inconsistent with SEC Regulation M, the agreement between the book-running lead manager and other syndicate members must require that any shares trading at a

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23 See SIFMA.

24 SIFMA also asked FINRA to clarify that anonymous, ordinary course sales on a national securities exchange or ATS at market prices will be considered a "random allocation" for the purposes of the rule. FINRA disagrees. The provision, as previously proposed would have required that, where no syndicate short position exists, the member must offer the returned shares to unfilled customer orders at the public offering price, not the market price. Moreover, if the shares are trading at a premium to the public offering price, then sales by the member at market prices would result in the premium inuring to the benefit of the member, which is inconsistent with the purpose of the provision and a member's obligations under FINRA Rule 5130.

premium to the public offering price returned by a purchaser to a syndicate member after secondary market trading commences be used to offset the existing syndicate short position.[25] However, where no syndicate short position exists, the proposed rule change would provide the member with the option, provided that it is in accordance with SEC Regulation M, to either: (1) offer returned shares at the public offering price to unfilled customers' orders pursuant to a random allocation methodology or (2) sell returned shares on the secondary market and donate profits from the sale to an "unaffiliated charitable organization" with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member.[26] Proposed FINRA Rule 5131 establishes a new definition of "unaffiliated charitable organization" to prevent such charitable donations from benefitting the member or executive officers and directors of the member (and persons they materially support). FINRA believes that charitable donations funded by returned shares should not provide any reputational benefit to the member. The definition of "unaffiliated charitable organization" is closely tied to specific information charities are required to file with the Internal Revenue Service.

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25 One commenter asked for confirmation that the appropriate time for determining whether returned shares are trading at a premium to their IPO price is at the time such securities are returned. We agree. See SIFMA. Another commenter argued that the requirement that members use a random allocation methodology to reallocate returned shares was inadequate. See Regal. We disagree and note that this standard is already used successfully in other FINRA rules. See FINRA Rule 2360 (Allocation of Exercise Assignment Notices**)**.

26 Proposed FINRA Rule 5131(e)(9) defines "unaffiliated charitable organization" as a tax-exempt entity organized under Section 501(c)(3) of the Internal Revenue Code that is not affiliated with the member and for which no executive officer or director of the member, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (i.e., officers, directors, trustees, key employees, highest compensated employees and certain independent contractors).

Members that choose this alternative must be able to demonstrate that their charitable donation was made in accordance with this rule.

The proposed rule change, as amended, prohibits the acceptance of market orders for the purchase of IPO shares prior to the commencement of trading on the secondary market. A commenter supported the proposed amendment but offered alternative rule text.[27] FINRA favors its existing rule text but proposes a slight modification in response to comments to further clarify the provision such that the relevant text will now state that "no member may accept a market order for the purchase of shares of a new issue in the secondary market prior to the commencement of trading of such shares in the secondary market."

Other Issues

Commenters reiterated certain concerns regarding FINRA's proposed provision relating to abusive allocation arrangements. Proposed FINRA Rule 5131(a) prohibits a member from offering or threatening to withhold shares it allocates in an IPO as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member (i.e., quid pro quo allocations). Commenters generally supported this proposed provision but reiterated earlier concerns that the term "excessive" is subject to uncertainty.[28] One commenter requested that FINRA clarify that any services provided for a "fair price" as provided by FINRA's Corporate Financing Rule (FINRA Rule 5110(a)(9)) would not be deemed excessive.[29] This commenter also

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27 See SIFMA.

28 See ABA and SIFMA.

29 See ABA.

requested guidance that any services provided by a member paid for using "soft dollars" in conformity with Section 28(e) of the Exchange Act also would not be deemed excessive.[30] Another commenter asked that clarifying language be added to the rule to provide that an assessment of whether compensation is excessive would be based on 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.[31]

As stated in Amendment No. 3, FINRA agrees that an assessment of whether or not compensation is excessive would 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.[32] However, FINRA continues to believe that the proposed language, which refers to "compensation that is excessive in relation to the services provided," is most appropriate in that it affords FINRA the necessary flexibility in addressing the range of potential quid pro quo arrangements that may arise. As stated in Amendment No. 3, we do not believe it is necessary to include rule text stating that an assessment of whether compensation is "excessive" will be based upon all of the relevant facts and circumstances.[33] Likewise, we do not believe it is appropriate to provide blanket guidance regarding payments made in conformity with Section 28(e) of the Exchange Act or FINRA Rule 5110(a)(9).

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30 See ABA.

31 See SIFMA.

32 See Amendment No. 3.

33 See Amendment No. 3.

Finally, one commenter raised concerns regarding FINRA's proposed flipping provision.[34] This commenter argued that, instead of defining the flipping period to mean the initial sale of new issue shares within 30 days following the offering date, the flipping provision should be based on the sale of shares prior to the book manager lifting the penalty bid, making the time period under the rule subject to the discretion of the managing underwriter.[35] FINRA does not agree that the suggested alternative represents an improvement to the proposed provision. FINRA believes that the certainty and finality of the proposed approach, including the 30-day window, is the appropriate duration for prohibiting members from recouping commissions from associated persons whose customers sell in cases where a penalty bid has not been assessed on the entire syndicate.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no less than 90 and no more than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[36] which require, 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.

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34 See Regal.

35 See Regal.

36 15 U.S.C. 78o–3(b)(6).

FINRA believes that the new, specifically targeted provisions in the proposed rule change will aid member compliance efforts and help to maintain investor confidence in the capital markets.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The SEC received three comment letters in response to Amendment No. 3 to the proposed rule change.[37] FINRA's response to comments is discussed in Section 3 above.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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[37] See note 4 supra.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2003-140 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2003-140. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2003-140 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[38]

Florence E. Harmon

Deputy Secretary

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[38] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the changes in this Amendment No. 4, with the proposed changes in Amendment No. 3 shown as if adopted. Proposed amendments in this Amendment No. 4 appear underlined; proposed deletions in this Amendment No. 4 appear in brackets.

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

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5131. [IPO] New Issue Allocations and Distributions

(a) Quid Pro Quo Allocations

No member or person associated with a member may offer or threaten to withhold shares it allocates of a new issue [in an initial public offering ("IPO")] as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.

(b) Spinning

(1) Members must establish, maintain and enforce policies and procedures reasonably designed to ensure that investment banking personnel have no involvement or influence, directly or indirectly, in the new issue allocation decisions of the member.

(2) No member or person associated with a member may allocate [IPO] shares of a new issue to any [the] account in which [of] an executive officer or director of a public company or a covered non-public company, or a person

materially supported by such executive officer or director, has a beneficial interest:

(A)[(1)] if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months;

(B)[(2)] if the person responsible for making the allocation decision knows or has reason to know that the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or

(C)[(3)] on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.

(3) The prohibitions in this paragraph shall not apply to allocations of shares of a new issue to any account described in Rule 5130(c)(1) through (3) and (5) through (10), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.

(c) Policies Concerning Flipping

(1) No member or person associated with a member may directly or indirectly recoup, or attempt to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares [in] of a[n] new issue [IPO]

that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate.

(2) In addition to any obligation to maintain records relating to penalty bids under SEA Rule 17a-2(c)(1), a member shall promptly record and maintain information regarding any penalties or disincentives assessed on its associated persons in connection with a penalty bid.

(d) [IPO] <u>New Issue</u> Pricing and Trading Practices

In a[n] <u>new issue</u> [equity IPO]:

(1) Reports of Indications of Interest and Final Allocations. The book-running lead manager must provide to the issuer's pricing committee (or, if the issuer has no pricing committee, its board of directors):

(A) a regular report of indications of interest, including the names of interested institutional investors and the number of shares indicated by each, as reflected in the book-running lead manager's book of potential institutional orders, and a report of aggregate demand from retail investors;

(B) after the settlement date of the [IPO] <u>new issue</u>, a report of the final allocation of shares to institutional investors as reflected in the books and records of the book-running lead manager including the names of purchasers and the number of shares purchased by each, and aggregate sales to retail investors;

(2) Lock-Up Agreements. Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer entered into in connection with a new issue shall provide that:

(A) Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer shall provide that such restrictions will apply to their issuer-directed shares; and

(B) At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service, except where the release or waiver is effected solely to permit a transfer of securities that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor;

(3) Agreement Among Underwriters. The agreement between the book-running lead manager and other syndicate members must require, to the extent not inconsistent with SEC Regulation M, that any shares trading at a premium to the public offering price that are returned by a purchaser to a syndicate member after secondary market trading commences:

(A) be used to [(a)] offset the existing syndicate short position, or

([b]B) if no syndicate short position exists, the member must either:

(i) offer returned shares at the public offering price to unfilled customers' orders pursuant to a random allocation methodology, or

(ii) sell returned shares on the secondary market and donate profits from the sale to an unaffiliated charitable organization with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member.

(4) Market Orders. No member may accept a market order for the purchase of [IPO] shares of a new issue in the secondary market prior to the commencement of trading of such shares [on] in the secondary market.

(e) Definitions

For purposes of this Rule, the following terms shall have the meanings stated below.

(1)[(7)] A "public company" is any company that is registered under Section 12 of the Exchange Act or files periodic reports pursuant to Section 15(d) thereof.

(2) "Beneficial interest" shall have the same meaning as in FINRA Rule 5130(i)(1). [Account of an executive officer or director" means any account in which an executive officer or director of a company, or a person materially supported by such executive officer or director, has a financial interest or over which such executive, director, or materially supported person has discretion or control, other than:]

[(A) an investment company registered under the Investment Company Act;]

[(B) any other investment fund over which neither an executive officer, director, or materially supported person has discretion or control, provided that executive officers, directors, and materially supported persons collectively own interests representing no more than 25% of the assets of such fund.]

(3) ["Initial public offering" or "IPO" is the initial public offering of an issuer's equity securities, which offering is registered under the Securities Act and as a result of which the issuer becomes a "public company" as defined below.]

"Covered non-public company" means any non-public company satisfying the following criteria: (i) income of at least $1 million in the last fiscal year or in two of the last three fiscal years and shareholders' equity of at least $15 million; (ii) shareholders' equity of at least $30 million and a two-year operating history; or (iii) total assets and total revenue of at least $75 million in the latest fiscal year or in two of the last three fiscal years.

(4)[(2)] "Flipped" means the initial sale of new issue [IPO] shares purchased in an offering within 30 days following the offering date of such offering.

(5)[(4)] "Investment banking services" include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger, acquisition or other corporate reorganization; providing venture capital, equity lines of credit, private investment, public equity

transactions (PIPEs) or similar investments or otherwise acting in furtherance of a private offering of the issuer; or serving as placement agent for the issuer.

(6)[(5)] "Material support" means directly or indirectly providing more than 25% of a person's income in the prior calendar year. Persons living in the same household are deemed to be providing each other with material support.

(7) "New issue" shall have the same meaning as in Rule 5130(i)(9).

(8)[(6)] "Penalty bid" means an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.

(9) "Unaffiliated charitable organization" is a tax-exempt entity organized under Section 501(c)(3) of the Internal Revenue Code that is not affiliated with the member and for which no executive officer or director of the member, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (i.e., officers, directors, trustees, key employees, highest compensated employees and certain independent contractors).

• • • Supplementary Material: ----------

.01 Issuer Directed Allocations. The prohibitions of paragraph (b) above shall not apply to allocations of securities that are directed in writing by the issuer, its affiliates, or selling shareholders, so long as the member has no involvement or influence, directly or indirectly, in the allocation decisions of the issuer, its affiliates, or selling shareholders with respect to such issuer-directed securities.

.02 Annual Representation. For the purposes of paragraph (b), a member may rely on a written representation obtained within the prior 12 months from the beneficial owner(s) of the account, or a person authorized to represent the beneficial owner(s) of the account, as to whether such beneficial owner(s) is an executive officer or director or person materially supported by an executive officer or director and if so, the company(ies) on whose behalf such executive officer or director serves. A member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. A member shall maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue under paragraph (b) in its files for at least three years following the member's allocation to that account.

.03 Lock-up Announcements. For the purposes of this Rule, the requirement that the book-running lead manager announce the impending release or waiver of a lock-up or other restriction on the transfer of the issuer's shares shall be deemed satisfied where such announcement is made by the book-running lead manager, another member or the issuer, so long as such announcement otherwise complies with the requirements of paragraph (d)(2) of this Rule.

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EXHIBIT 5

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5131. New Issue Allocations and Distributions

(a) Quid Pro Quo Allocations

No member or person associated with a member may offer or threaten to withhold shares it allocates of a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.

(b) Spinning

(1) Members must establish, maintain and enforce policies and procedures reasonably designed to ensure that investment banking personnel have no involvement or influence, directly or indirectly, in the new issue allocation decisions of the member.

(2) No member or person associated with a member may allocate shares of a new issue to any account in which an executive officer or director of a public company or a covered non-public company, or a person materially supported by such executive officer or director, has a beneficial interest:

(A) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months;

(B) if the person responsible for making the allocation decision knows or has reason to know that the member intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or

(C) on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.

(3) The prohibitions in this paragraph shall not apply to allocations of shares of a new issue to any account described in Rule 5130(c)(1) through (3) and (5) through (10), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.

(c) Policies Concerning Flipping

(1) No member or person associated with a member may directly or indirectly recoup, or attempt to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate.

(2) In addition to any obligation to maintain records relating to penalty bids under SEA Rule 17a-2(c)(1), a member shall promptly record and maintain information regarding any penalties or disincentives assessed on its associated persons in connection with a penalty bid.

(d) New Issue Pricing and Trading Practices

In a new issue:

(1) Reports of Indications of Interest and Final Allocations. The book-running lead manager must provide to the issuer's pricing committee (or, if the issuer has no pricing committee, its board of directors):

(A) a regular report of indications of interest, including the names of interested institutional investors and the number of shares indicated by each, as reflected in the book-running lead manager's book of potential institutional orders, and a report of aggregate demand from retail investors;

(B) after the settlement date of the new issue, a report of the final allocation of shares to institutional investors as reflected in the books and records of the book-running lead manager including the names of purchasers and the number of shares purchased by each, and aggregate sales to retail investors;

(2) Lock-Up Agreements. Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer entered into in connection with a new issue shall provide that:

(A) Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer shall provide that such restrictions will apply to their issuer-directed shares; and

(B) At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service, except where the release or waiver is effected solely to permit a transfer of securities that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor;

(3) Agreement Among Underwriters. The agreement between the book-running lead manager and other syndicate members must require, to the extent not inconsistent with SEC Regulation M, that any shares trading at a premium to the public offering price that are returned by a purchaser to a syndicate member after secondary market trading commences:

(A) be used to offset the existing syndicate short position, or

(B) if no syndicate short position exists, the member must either:

(i) offer returned shares at the public offering price to unfilled customers' orders pursuant to a random allocation methodology, or

(ii) sell returned shares on the secondary market and donate profits from the sale to an unaffiliated charitable

organization with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member.

(4) Market Orders. No member may accept a market order for the purchase of shares of a new issue in the secondary market prior to the commencement of trading of such shares in the secondary market.

(e) Definitions

For purposes of this Rule, the following terms shall have the meanings stated below.

(1) A "public company" is any company that is registered under Section 12 of the Exchange Act or files periodic reports pursuant to Section 15(d) thereof.

(2) "Beneficial interest" shall have the same meaning as in FINRA Rule 5130(i)(1).

(3) "Covered non-public company" means any non-public company satisfying the following criteria: (i) income of at least $1 million in the last fiscal year or in two of the last three fiscal years and shareholders' equity of at least $15 million; (ii) shareholders' equity of at least $30 million and a two-year operating history; or (iii) total assets and total revenue of at least $75 million in the latest fiscal year or in two of the last three fiscal years.

(4) "Flipped" means the initial sale of new issue shares purchased in an offering within 30 days following the offering date of such offering.

(5) "Investment banking services" include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or

otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger, acquisition or other corporate reorganization; providing venture capital, equity lines of credit, private investment, public equity transactions (PIPEs) or similar investments or otherwise acting in furtherance of a private offering of the issuer; or serving as placement agent for the issuer.

(6) "Material support" means directly or indirectly providing more than 25% of a person's income in the prior calendar year. Persons living in the same household are deemed to be providing each other with material support.

(7) "New issue" shall have the same meaning as in Rule 5130(i)(9).

(8) "Penalty bid" means an arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.

(9) "Unaffiliated charitable organization" is a tax-exempt entity organized under Section 501(c)(3) of the Internal Revenue Code that is not affiliated with the member and for which no executive officer or director of the member, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (i.e., officers, directors, trustees, key employees, highest compensated employees and certain independent contractors).

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selling shareholders, so long as the member has no involvement or influence, directly or indirectly, in the allocation decisions of the issuer, its affiliates, or selling shareholders with respect to such issuer-directed securities.

.02 Annual Representation. For the purposes of paragraph (b), a member may rely on a written representation obtained within the prior 12 months from the beneficial owner(s) of the account, or a person authorized to represent the beneficial owner(s) of the account, as to whether such beneficial owner(s) is an executive officer or director or person materially supported by an executive officer or director and if so, the company(ies) on whose behalf such executive officer or director serves. A member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. A member shall maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue under paragraph (b) in its files for at least three years following the member's allocation to that account.

.03 Lock-up Announcements. For the purposes of this Rule, the requirement that the book-running lead manager announce the impending release or waiver of a lock-up or other restriction on the transfer of the issuer's shares shall be deemed satisfied where such announcement is made by the book-running lead manager, another member or the issuer, so long as such announcement otherwise complies with the requirements of paragraph (d)(2) of this Rule.

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