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

File No.* SR - 2013 - * 037
Amendment No. (req. for Amendments *)

Filing by Financial Industry Regulatory Authority

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) *
☑	☐	☐	☑	☐	☐

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

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) ☐ Section 806(e)(2) ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

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

Proposed Rule Change to Amend FINRA Rule 5131 (New Issue Allocations and Distributions)

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 action.

First Name * Racquel Last Name * Russell
Title * Associate 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.

Date 08/23/2013

By Stephanie M. Dumont

(Name *)

(Title *)

Senior Vice President and Director of Capital Markets Policy

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.

Stephanie Dumont,

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information * 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 * 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 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies 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, security-based swap submission, or advance notice 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 the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend FINRA Rule 5131 (New Issue Allocations and Distributions) to allow members to rely on written representations from certain accounts to comply with Rule 5131(b) related to spinning.

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 February 15, 2012, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. 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 later than 120 days following Commission approval.

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

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

(a) Purpose

FINRA Rule 5131 (New Issue Allocations and Distributions) (the "Rule") addresses abuses in the allocation and distribution of "new issues."[2] Rule 5131(b) prohibits the practice of spinning, which refers to an underwriter's allocation of new issue shares to executive officers and directors of a company as an inducement to award the underwriter with investment banking business, or as consideration for investment banking business previously awarded (the "spinning" provision).

Specifically, the spinning provision provides that 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[3] or a covered non-public company,[4] or a person materially supported[5] by such executive officer or director, has a beneficial interest:[6]

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[2] Rule 5131 provides that "new issue" shall have the same meaning as in Rule 5130(i)(9).

[3] 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. See Rule 5131(e)(1).

[4] The Rule defines a "covered non-public company" as 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. See Rule 5131(e)(3).

[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. See Rule 5131(e)(6).

[6] The Rule provides that the term "beneficial interest" shall have the same meaning as in Rule 5130(i)(1).

- if the company is currently an investment banking services[7] client of the member or the member has received compensation from the company for investment banking services in the past 12 months;
- 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 three months; or
- 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.

Rule 5131.02 (Annual Representation) provides that, for the purposes of the spinning provision, a member may rely on a written representation obtained within the prior 12 months from the beneficial owner(s) of an 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 on whose behalf such executive officer or director serves. Therefore, to comply with the spinning provision, firms typically issue questionnaires to their

[7] "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. See Rule 5131(e)(5).

customers to ascertain whether any of the persons covered by the spinning provision have a beneficial interest in the account.[8]

Rule 5131(b)(2) provides a de minimis exception for new issue allocations to any account in which the beneficial interests of executive officers and directors of a company subject to the rule, and persons materially supported by such executive officers and directors, do not exceed in the aggregate 25% of such account. FINRA understands that members (and their customers) have had difficulty obtaining, tracking and aggregating information from funds regarding indirect beneficial owners, such as participants in a fund of funds, for use in determining an account's eligibility for the de minimis exception and that this has resulted in compliance difficulties and restrictions, including in situations where the ability of an underwriter to confer any meaningful financial benefit to a particular investor by allocating new issue shares to the account is impracticable.[9]

FINRA believes that certain funds, owing to several mitigating factors including their size, lack of affiliation with the account directly receiving the allocation and layered (and often opaque) ownership structure, generally do not raise the concerns that the Rule is designed to address. Moreover, where the potential profits from a new issue allocation are spread across a large and diverse investor base, it is unlikely that the proportional benefit to any particular indirect investor would be of an amount that would further

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8 The spinning provision currently addresses operational burdens associated with some accounts with a large and diverse ownership base where the potential for spinning is minimal through a series of exemptions for purchasers such as mutual funds, insurance company general accounts and various employee benefit plans. See generally Rule 5130(c). Private funds, however, are not a category of purchasers for which a general exemption exists.

9 For example, members have noted that broker-dealers normally do not know the identity of the beneficial owners of the fund of funds invested in the account.

spinning (i.e., indirect fund ownership can be an impractical and ineffective means to receive any benefit from spinning). Therefore, FINRA is proposing a limited exception to the spinning provision in the fund of funds context that includes a set of conditions designed to ensure that the important protections of the Rule continue to be preserved, while offering meaningful relief for members and investors in situations where spinning abuse is not likely.

Specifically, FINRA is proposing to provide that members may rely upon a written representation obtained within the prior 12 months from a person authorized to represent an account that does not look through to the indirect beneficial owners of a fund invested in the account, that such fund:

- is a "private fund" as defined in the Investment Advisers Act of 1940;[10]
- is managed by an investment adviser;
- has assets greater than $50 million;
- owns less than 25% of the account and is not a fund in which a single investor has a beneficial interest of 25% or more;
- does not have a beneficial owner that also is a control person of such fund's investment adviser;

[10] Section 202(a)(29) of the Investment Advisers Act of 1940 defines the term "private fund" as an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) ("Investment Company Act"), but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act.

- is "unaffiliated" with the account in that the private fund's investment adviser does not have a control person in common with the account's investment adviser;[11] and
- was not formed for the specific purpose of investing in the account.

FINRA believes that these conditions are reasonable to assure that a member's new issue allocation will not be in furtherance of spinning, while reducing the compliance burdens associated with the Rule. In addition, a member may rely upon a written representation by an account as to the availability of this proposed exception unless it believes, or has reason to believe, that such representation is inaccurate. Members availing themselves of the new supplementary material must maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue under the spinning provision in its files for at least three years following the member's allocation to that account.

FINRA discussed with FINRA committees, industry groups and member firms the logistical impracticalities, costs and other hurdles involved in attempting to track beneficial ownership. The comments are described in detail in Item 5 below. The proposal takes those discussions into account.

FINRA has considered various alternatives to the current approach, including proposing an exception for all private funds meeting certain asset thresholds, providing an interpretation to the existing de minimis exception, or requiring alternative percentage caps for direct and indirect beneficial ownership in the account. In considering these and other alternatives, FINRA sought to balance preserving the protections the Rule was

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[11] A control person of an investment adviser is a person with direct or indirect "control" over the investment adviser, as that term is defined in Form ADV.

designed to provide with limiting the scope of the rule to situations that might reasonably result in the harms sought to be addressed. FINRA also sought to avoid increasing complexity in the Rule, with added compliance costs, where the concerns to be avoided were remote.

As a result, FINRA determined that a wholesale exception for private funds was not appropriate.[12] In addition, because a fund indirectly invested in the account could consist of a single investor – potentially including covered persons – FINRA believes that a limit to both direct and indirect beneficial ownership is important in preserving the efficacy of the spinning provision. The proposed rule change is intended to balance the compliance concerns and burdens noted by the industry with FINRA's goal of assuring that the Rule continues to be designed to promote investor confidence and prevent fraudulent and manipulative behaviors.

As noted in Item 2 of this filing, 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 later than 120 days following 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,[13] which requires, among other things, that FINRA rules must 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

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12 See supra note 8.

13 15 U.S.C. 78o–3(b)(6).

interest. FINRA believes that the proposed exception and required conditions will further these purposes by promoting capital formation and aiding member compliance efforts, while maintaining investor confidence in the capital markets.

Specifically, the proposed condition that the fund be managed by an investment adviser that is unaffiliated with the account's investment adviser seeks to ensure the structural independence of the funds' respective advisers. This requirement, in addition to the proviso that the unaffiliated private fund must not have been formed for the specific purpose of investing in the account, seeks to mitigate the possibility of collusive conduct aimed at furthering spinning.

In addition, the condition providing that the unaffiliated private fund may not have any beneficial owners who also are control persons of such fund's investment adviser seeks to eliminate the conflict that may exist where an adviser also is an investor in the fund and, therefore, may directly benefit from allocation decisions. The requirements regarding the minimum size of the private fund (over $50 million) and the percentage ownership thresholds (private fund must own less than 25% of the account and not be a fund in which a single investor has a beneficial interest of 25% or more) seek to ensure that the proportional benefit of any new issue allocation to a single indirect beneficial owner would be insufficient to further spinning.

4. <u>Self-Regulatory Organization's Statement on Burden on Competition</u>

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 in that the proposed rule provides an exception to Rule 5131(b) for funds of funds that face special difficulties under the existing exemptions from the Rule, and thus the

proposed exemption tries to reduce differential impacts of the Rule. FINRA also believes that it is reasonable to permit members to rely on written representations from the account regarding compliance with the conditions of the exception as a means of achieving compliance with the purposes of the Rule without imposing layered tracking and other requirements on members that could be costly and unduly hamper the accounts' access to new issue shares.

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

FINRA received four letters regarding the issues addressed by the proposed rule change from three commenters,[14] and engaged in additional discussions with industry groups and market participants regarding the operation of the spinning provision, the operation of the existing de minimis exception and members' difficulty in identifying indirect beneficial owners of an account. A list of the commenters is attached as Exhibit 2a. Copies of the comment letters received are attached as Exhibit 2b.

Commenters sought either interpretive guidance regarding the existing de minimis exception to increase its scope or a new amendment to address difficulties in allocating to investment funds, particularly in the fund of funds context. Commenters argued that

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14 See Letters from Gregory J. Robbins, Senior Managing Director and General Counsel, Mesirow Advanced Strategies, Inc., to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of the General Counsel, FINRA, dated June 10, 2011 ("Mesirow"); Andrew Baker, Chief Executive Officer, Alternative Investment Management Association, to Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA, dated August 3, 2011 ("AIMA"); Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated August 19, 2011 ("MFA #1"); and Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated October 4, 2011 ("MFA #2").

investment funds are not an effective tool for a broker-dealer to convey a meaningful benefit to a particular covered person.[15] One commenter stated that the funds of funds it offers have investments in anywhere from 25 to 70 unaffiliated portfolio funds.[16] The commenter further noted that investors in a fund of funds, including any potential covered persons, cannot direct which broker a portfolio fund uses or will use, and may not know in which portfolio funds the fund of funds is invested.[17]

Commenters also discussed the logistical impracticalities and other hurdles involved in attempting to track beneficial ownership.[18] A commenter stated that, as currently structured, the spinning provisions potentially would require significant amounts of time and money to implement.[19] In addition, another commenter generally stated that funds of funds may (and often do) have several hundred investors, each of which themselves may have hundreds of beneficial owners; thus, the operational hurdles and cost of obtaining the relevant representations from all of the ultimate beneficial owners would be substantial.[20] The commenter further stated that obtaining beneficial ownership information is not always possible due to confidentiality and investor privacy concerns.[21]

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15 See AIMA, Mesirow, MFA #1 and MFA #2.

16 See Mesirow.

17 See Mesirow.

18 See e.g., AIMA, MFA #1 and MFA #2.

19 See AIMA.

20 See MFA #2.

21 See MFA #1.

FINRA has carefully considered the comments received and has considered the various alternatives suggested in crafting the current proposal and believes that the proposed rule change strikes the appropriate balance by simplifying the operation of the Rule while maintaining the protections the spinning provision is designed to provide, as discussed above.[22]

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.[23]

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

Not applicable.

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

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

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[22] One commenter suggested, among other things, that the existing 25% de minimis exception be interpreted to apply separately to each public company or covered non-public company. However, the rule clearly states that the calculation is to be applied in the aggregate for all covered companies and the proposal would not change that requirement. See AIMA.

[23] 15 U.S.C. 78s(b)(2).

11. **Exhibits**

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

Exhibit 2a. List of commenters.

Exhibit 2b. Comment letters.

Exhibit 5. Text of proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2013-037)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 5131 (New Issue Allocations and Distributions)

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 , Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") 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 to amend FINRA Rule 5131 (New Issue Allocations and Distributions) to provide a limited exception to allow members to rely on written representations from certain accounts to comply with Rule 5131(b).

The text of the proposed rule change is available on FINRA's website 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

FINRA Rule 5131 (New Issue Allocations and Distributions) (the "Rule") addresses abuses in the allocation and distribution of "new issues."[3] Rule 5131(b) prohibits the practice of spinning, which refers to an underwriter's allocation of new issue shares to executive officers and directors of a company as an inducement to award the underwriter with investment banking business, or as consideration for investment banking business previously awarded (the "spinning" provision).

Specifically, the spinning provision provides that no member or person associated with a member may allocate shares of a new issue to any account in which an executive

[3] Rule 5131 provides that "new issue" shall have the same meaning as in Rule 5130(i)(9).

officer or director of a public company[4] or a covered non-public company,[5] or a person materially supported[6] by such executive officer or director, has a beneficial interest:[7]

- if the company is currently an investment banking services[8] client of the member or the member has received compensation from the company for investment banking services in the past 12 months;
- 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 three months; or

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4 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. See Rule 5131(e)(1).

5 The Rule defines a "covered non-public company" as 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. See Rule 5131(e)(3).

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. See Rule 5131(e)(6).

7 The Rule provides that the term "beneficial interest" shall have the same meaning as in Rule 5130(i)(1).

8 "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. See Rule 5131(e)(5).

- 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.

Rule 5131.02 (Annual Representation) provides that, for the purposes of the spinning provision, a member may rely on a written representation obtained within the prior 12 months from the beneficial owner(s) of an 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 on whose behalf such executive officer or director serves. Therefore, to comply with the spinning provision, firms typically issue questionnaires to their customers to ascertain whether any of the persons covered by the spinning provision have a beneficial interest in the account.[9]

Rule 5131(b)(2) provides a de minimis exception for new issue allocations to any account in which the beneficial interests of executive officers and directors of a company subject to the rule, and persons materially supported by such executive officers and directors, do not exceed in the aggregate 25% of such account. FINRA understands that members (and their customers) have had difficulty obtaining, tracking and aggregating information from funds regarding indirect beneficial owners, such as participants in a fund of funds, for use in determining an account's eligibility for the de minimis exception and that this has resulted in compliance difficulties and restrictions, including in

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[9] The spinning provision currently addresses operational burdens associated with some accounts with a large and diverse ownership base where the potential for spinning is minimal through a series of exemptions for purchasers such as mutual funds, insurance company general accounts and various employee benefit plans. See generally Rule 5130(c). Private funds, however, are not a category of purchasers for which a general exemption exists.

situations where the ability of an underwriter to confer any meaningful financial benefit to a particular investor by allocating new issue shares to the account is impracticable.[10]

FINRA believes that certain funds, owing to several mitigating factors including their size, lack of affiliation with the account directly receiving the allocation and layered (and often opaque) ownership structure, generally do not raise the concerns that the Rule is designed to address. Moreover, where the potential profits from a new issue allocation are spread across a large and diverse investor base, it is unlikely that the proportional benefit to any particular indirect investor would be of an amount that would further spinning (i.e., indirect fund ownership can be an impractical and ineffective means to receive any benefit from spinning). Therefore, FINRA is proposing a limited exception to the spinning provision in the fund of funds context that includes a set of conditions designed to ensure that the important protections of the Rule continue to be preserved, while offering meaningful relief for members and investors in situations where spinning abuse is not likely.

Specifically, FINRA is proposing to provide that members may rely upon a written representation obtained within the prior 12 months from a person authorized to represent an account that does not look through to the indirect beneficial owners of a fund invested in the account, that such fund:

- is a "private fund" as defined in the Investment Advisers Act of 1940;[11]

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[10] For example, members have noted that broker-dealers normally do not know the identity of the beneficial owners of the fund of funds invested in the account.

[11] Section 202(a)(29) of the Investment Advisers Act of 1940 defines the term "private fund" as an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) ("Investment Company Act"), but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act.

- is managed by an investment adviser;
- has assets greater than $50 million;
- owns less than 25% of the account and is not a fund in which a single investor has a beneficial interest of 25% or more;
- does not have a beneficial owner that also is a control person of such fund's investment adviser;
- is "unaffiliated" with the account in that the private fund's investment adviser does not have a control person in common with the account's investment adviser;[12] and
- was not formed for the specific purpose of investing in the account.

FINRA believes that these conditions are reasonable to assure that a member's new issue allocation will not be in furtherance of spinning, while reducing the compliance burdens associated with the Rule. In addition, a member may rely upon a written representation by an account as to the availability of this proposed exception unless it believes, or has reason to believe, that such representation is inaccurate. Members availing themselves of the new supplementary material must maintain a copy of all records and information relating to whether an account is eligible to receive an allocation of the new issue under the spinning provision in its files for at least three years following the member's allocation to that account.

FINRA discussed with FINRA committees, industry groups and member firms the logistical impracticalities, costs and other hurdles involved in attempting to track

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[12] A control person of an investment adviser is a person with direct or indirect "control" over the investment adviser, as that term is defined in Form ADV.

beneficial ownership. The comments are described in detail in Item 5 below. The proposal takes those discussions into account.

FINRA has considered various alternatives to the current approach, including proposing an exception for all private funds meeting certain asset thresholds, providing an interpretation to the existing de minimis exception, or requiring alternative percentage caps for direct and indirect beneficial ownership in the account. In considering these and other alternatives, FINRA sought to balance preserving the protections the Rule was designed to provide with limiting the scope of the rule to situations that might reasonably result in the harms sought to be addressed. FINRA also sought to avoid increasing complexity in the Rule, with added compliance costs, where the concerns to be avoided were remote.

As a result, FINRA determined that a wholesale exception for private funds was not appropriate.[13] In addition, because a fund indirectly invested in the account could consist of a single investor – potentially including covered persons – FINRA believes that a limit to both direct and indirect beneficial ownership is important in preserving the efficacy of the spinning provision. The proposed rule change is intended to balance the compliance concerns and burdens noted by the industry with FINRA's goal of assuring that the Rule continues to be designed to promote investor confidence and prevent fraudulent and manipulative behaviors.

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 later than 120 days following Commission approval.

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[13] See supra note 9.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[14] which requires, among other things, that FINRA rules must 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. FINRA believes that the proposed exception and required conditions will further these purposes by promoting capital formation and aiding member compliance efforts, while maintaining investor confidence in the capital markets.

Specifically, the proposed condition that the fund be managed by an investment adviser that is unaffiliated with the account's investment adviser seeks to ensure the structural independence of the funds' respective advisers. This requirement, in addition to the proviso that the unaffiliated private fund must not have been formed for the specific purpose of investing in the account, seeks to mitigate the possibility of collusive conduct aimed at furthering spinning.

In addition, the condition providing that the unaffiliated private fund may not have any beneficial owners who also are control persons of such fund's investment adviser seeks to eliminate the conflict that may exist where an adviser also is an investor in the fund and, therefore, may directly benefit from allocation decisions. The requirements regarding the minimum size of the private fund (over $50 million) and the percentage ownership thresholds (private fund must own less than 25% of the account and not be a fund in which a single investor has a beneficial interest of 25% or more)

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[14] 15 U.S.C. 78o–3(b)(6).

seek to ensure that the proportional benefit of any new issue allocation to a single indirect beneficial owner would be insufficient to further spinning.

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 in that the proposed rule provides an exception to Rule 5131(b) for funds of funds that face special difficulties under the existing exemptions from the Rule, and thus the proposed exemption tries to reduce differential impacts of the Rule. FINRA also believes that it is reasonable to permit members to rely on written representations from the account regarding compliance with the conditions of the exception as a means of achieving compliance with the purposes of the Rule without imposing layered tracking and other requirements on members that could be costly and unduly hamper the accounts' access to new issue shares.

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

FINRA received four letters regarding the issues addressed by the proposed rule change from three commenters,[15] and engaged in additional discussions with industry

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15 See Letters from Gregory J. Robbins, Senior Managing Director and General Counsel, Mesirow Advanced Strategies, Inc., to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of the General Counsel, FINRA, dated June 10, 2011 ("Mesirow"); Andrew Baker, Chief Executive Officer, Alternative Investment Management Association, to Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA, dated August 3, 2011 ("AIMA"); Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated August 19, 2011 ("MFA #1"); and Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated October 4, 2011 ("MFA #2").

groups and market participants regarding the operation of the spinning provision, the operation of the existing de minimis exception and members' difficulty in identifying indirect beneficial owners of an account. A list of the commenters is attached as Exhibit 2a. Copies of the comment letters received are attached as Exhibit 2b.

Commenters sought either interpretive guidance regarding the existing de minimis exception to increase its scope or a new amendment to address difficulties in allocating to investment funds, particularly in the fund of funds context. Commenters argued that investment funds are not an effective tool for a broker-dealer to convey a meaningful benefit to a particular covered person.[16] One commenter stated that the funds of funds it offers have investments in anywhere from 25 to 70 unaffiliated portfolio funds.[17] The commenter further noted that investors in a fund of funds, including any potential covered persons, cannot direct which broker a portfolio fund uses or will use, and may not know in which portfolio funds the fund of funds is invested.[18]

Commenters also discussed the logistical impracticalities and other hurdles involved in attempting to track beneficial ownership.[19] A commenter stated that, as currently structured, the spinning provisions potentially would require significant amounts of time and money to implement.[20] In addition, another commenter generally stated that funds of funds may (and often do) have several hundred investors, each of

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16 See AIMA, Mesirow, MFA #1 and MFA #2.

17 See Mesirow.

18 See Mesirow.

19 See e.g., AIMA, MFA #1 and MFA #2.

20 See AIMA.

which themselves may have hundreds of beneficial owners; thus, the operational hurdles and cost of obtaining the relevant representations from all of the ultimate beneficial owners would be substantial.[21] The commenter further stated that obtaining beneficial ownership information is not always possible due to confidentiality and investor privacy concerns.[22]

FINRA has carefully considered the comments received and has considered the various alternatives suggested in crafting the current proposal and believes that the proposed rule change strikes the appropriate balance by simplifying the operation of the Rule while maintaining the protections the spinning provision is designed to provide, as discussed above.[23]

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

Within 45 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 or disapprove such proposed rule change, or

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

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21 See MFA #2.

22 See MFA #1.

23 One commenter suggested, among other things, that the existing 25% de minimis exception be interpreted to apply separately to each public company or covered non-public company. However, the rule clearly states that the calculation is to be applied in the aggregate for all covered companies and the proposal would not change that requirement. See AIMA.

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-FINRA-2013-037 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-FINRA-2013-037. 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 website (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 website 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-FINRA-2013-037 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.[24]

Elizabeth M. Murphy

Secretary

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[24] 17 CFR 200.30-3(a)(12).

Exhibit 2a

List of the comment letters received on the proposed rule change.

1. Letter from Gregory J. Robbins, Senior Managing Director and General Counsel, Mesirow Advanced Strategies, Inc., to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of the General Counsel, FINRA, dated June 10, 2011.

2. Letter from Andrew Baker, Chief Executive Officer, Alternative Investment Management Association, to Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA, dated August 3, 2011.

3. Letter from Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated August 19, 2011.

4. Letter from Stuart J. Kaswell, Executive Vice President and Managing Director and General Counsel, Managed Funds Association, to Marc Menchel, Executive Vice President and General Counsel, FINRA, dated October 4, 2011.

Exhibit 2b

353 North Clark Street, Chicago, Illinois 60654
312.595.6200 • www.mesirowfinancial.com

June 10, 2011

Via Email: gary.goldsholle@finra.org
Gary L. Goldsholle
Vice-President and Associate General Counsel
Office of General Counsel
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006

Re: Financial Industry Regulatory Authority ("FINRA") Rule 5131(b) (New Issue Allocations and Distributions — Spinning)

Dear Mr. Goldsholle,

Thank you for taking the time to discuss with me the application of Rule 5131(b) to private investment funds-of-funds ("FOFs") on our call of March 16, 2011. I am writing to you as a follow up to the issues discussed on that call.

As a FOFs manager, Mesirow Advanced Strategies, Inc. ("MAS") is a firm believer in FINRA's goal of protecting the integrity of the markets, and we support the implementation of market regulation that is effective and targeted. We, therefore, appreciate and applaud FINRA's efforts to attempt to curb "spinning" practices through the implementation of Rule 5131(b). Rule 5131(b), which prohibits allocations of new issues to executive officers and directors of current, and certain former or prospective, investment banking clients of a FINRA member, is designed to ensure that investment banking clients "have no involvement or influence, directly or indirectly, on the new issue allocation decisions of the [FINRA] member."[1] We agree with FINRA's position that "[b]ecause such persons are often in a position to hire FINRA [members] on behalf of the companies they serve, allocating new issues to such persons creates the appearance of impropriety and has the potential to divide the loyalty of the agents of the company (*i.e.*, the executive officers and directors) from the principal (*i.e.*, the company) on whose behalf they must act."[2] However, as discussed on our call, we believe that the application of Rule 5131(b) to FOFs is unlikely to further FINRA's very important interests in prohibiting spinning abuses. At the same time, unfortunately, Rule 5131(b) will likely result in the exclusion of FOF investors (including corporate pension plans, union pension plans, and government investment funds) from new issues participation.

As we discussed on our call, by its nature, a FOF is not an effective tool for an investor to collude with a broker for the investor's benefit. A FOF typically invests in a diversified portfolio of private investment funds and/or managed accounts (collectively, the "Portfolio Funds") advised by unaffiliated investment managers ("Portfolio Managers"). For example, the FOFs offered by MAS have investments in anywhere from approximately 25 to 70 Portfolio Funds, depending on the strategy employed by the FOF. None of the Portfolio Managers to those Portfolio Funds is affiliated with MAS. Investors in FOFs typically do not know which Portfolio Funds a FOF is invested in, and are not notified when the investment adviser to the FOF is going to invest in a new Portfolio Fund, redeem from an existing Portfolio Fund, or rebalance investments among Portfolio Funds. Instead, allocations to, redemptions from, and reallocations among Portfolio Funds are made regularly by the FOF's investment adviser without prior or subsequent notification to the investors in the FOF. Even when an investor in a FOF may receive reporting as to

[1] FINRA Regulatory Notice 10-60, Approval of New Issue Rule, November 2010, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122490.pdf.
[2] Id.

which Portfolio Funds a FOF invests in, neither the FOF manager nor the investors in the FOF have the ability to direct which broker the Portfolio Fund will use in general or for any particular trade (including new issues investments). Additionally, Portfolio Funds typically utilize multiple brokers and change brokers regularly. Neither the Portfolio Funds nor the Portfolio Managers advise the FOF manager or the investors in the FOF in advance of changes in brokers, or of what broker may be used for any particular trade.

As already noted, the goal of 5131(b) is to prevent an executive officer or director of a covered company from colluding with a broker to receive new issues allocations. However, in light of the fact that investors in a FOF cannot direct which brokers any Portfolio Fund uses or will use—and in most instances do not even know what Portfolio Funds a FOF is invested in or what brokers those Portfolio Funds may use—there is simply no opportunity for collusion.

Because it would be impossible for an investor in a FOF to try to engage in a *quid pro quo* with any particular broker in the hopes of getting a new issue allocation made to a Portfolio Fund in which the FOF invests in instances in which the FOF investor has no knowledge or control over the brokers to be used by any Portfolio Fund, we would like to propose that FINRA provide relief from the prohibitions of Rule 5131(b) to any FOF that complies with each of the following prongs:

(1) none of the FOF, the FOF manager, nor any FOF investor determine the brokers used by the Portfolio Funds;

(2) neither the FOF nor the FOF manager disclose the brokers currently used by any particular Portfolio Fund to investors in the FOF that participate in new issues; and

(3) the FOF receives representations and warranties from each of its investors that participate in new issues that the investor has not invested in the FOF to avoid the application of Rule 5131(b).

A FOF that complies, and represents to its Portfolio Funds that it is in compliance, with the foregoing test should be treated by those Portfolio Funds as an unrestricted person for Rule 5131(b) purposes.

While we strongly believe that the lack of knowledge and control vested in FOF investors regarding brokers used by Portfolio Funds is sufficient to demonstrate that FOF investments that comply with these three prongs cannot be tools for collusive spinning between FOF investors and brokers, we would also point out how impractical it would be for a FOF investor to try to receive an economic benefit tied to spinning from an investment in a FOF. FOFs typically limit their investment with any particular Portfolio Manager so that the FOF represents less than 10% of the Portfolio Manager's assets under management. FOFs also typically have a diversified investor base. For example, our primary commingled multi-strategy FOF for ERISA and benefit plan investors (the "MAS Plan Assets FOF") has approximately 89 investors, and no investor owns in excess of 7% of that FOF. Finally, Portfolio Funds typically do not invest more than 10% of their assets in any one investment. In light of these facts, the typical FOF investor will receive at most a miniscule, *pro rata* allocation of a new issue allocation made to a Portfolio Fund in which the FOF invests. To provide more context, assume an executive officer ("EO") of a public company ("PubCo") decided to invest $5,000,000 of her IRA in the MAS Plan Assets FOF with the thought that she would get a *quid pro quo* of new issues allocations from a prime broker ("Broker") that does investment banking business with PubCo. Her $5,000,000 investment would represent only 0.4% of the MAS Plan Assets FOF. Because the MAS Plan Assets FOF currently invests in 56 Portfolio Funds and does not invest more than 6% of its assets in any Portfolio Fund, the EO's greatest *pro rata* exposure to any one Portfolio Fund is less than 6% of her $5,000,000, or $300,000. In reality, the EO would not actually know what Portfolio Funds the MAS Plan Assets FOF invests in, and even if she did know, she would not know what broker any particular Portfolio Fund uses in general or for any specific transaction. Also, the EO would not know that any Portfolio Fund will trade new issues. But even if:

(A) the EO somehow knew at the time of her investment in the MAS Plan Assets FOF that (i) the MAS Plan Assets FOF was invested in a particular Portfolio Fund, (ii) at some point in

the future that Portfolio Fund would invest in a new issue, and (iii) that Portfolio Fund would use the Broker for that new issue transaction (none of which could happen),

(B) the EO was able to collude with the Broker on that transaction even though she does not control the Portfolio Fund (which also could not happen), and

(C) we assume that the MAS Plan Assets FOF does not own more than 10% of any Portfolio Fund (which is most often the case) and that the Portfolio Fund invested 10% of its assets in the IPO (a hugely concentrated position),

the EO's indirect ownership interest in the Portfolio Fund would represent at most 0.04% of that Portfolio Fund and she would receive at most 0.0004% of that IPO on a pass-through basis. This is a chain of impossible scenarios with an outcome that makes no economic sense for the EO or the Broker to collude with respect to any IPO.

Given that this is the typical scenario for FOFs and their investors, it is inconceivable that a corporate executive officer or director would funnel business to a broker and then invest in a FOF in an attempt to somehow receive *quid pro quo* new issues allocations from that broker in its role as the broker to a third-party advised Portfolio Fund. Therefore, applying Rule 5131(b) to FOFs simply will not further the stated purpose of Rule 5131(b) — the prevention of spinning practices.

However, it is clear that the application of Rule 5131(b) to FOFs would impose significant burdens on the FOFs and their investors. Given that FOFs may have (and often do have) several hundred investors, each of which may themselves have multiple hundreds of beneficial owners, the practical and operational hurdles, as well as the cost and expense, of obtaining the relevant representations from all of the ultimate beneficial owners, will be substantial. Moreover, the ongoing costs of monitoring the FOFs' and their investors' compliance with Rule 5131(b), including obtaining annual certifications from investors, will be material. Additionally, in order to comply with 5131(b) while not prejudicing other investors, a FOF and each Portfolio Fund would be required to set up new classes for each covered company that has executive officers or directors with investments in the FOF and Portfolio Fund. The number of new classes will cause an operational and accounting morass that could be so intractable that we suspect that most Portfolio Funds will simply treat as restricted any FOF (or other investor) that has any beneficial ownership by an executive officer or director of a covered company. Thus, not only do investors in FOFs face increased costs and expenses due to the difficulties in implementing Rule 5131(b), they likely will be completely prohibited from participation in new issues gains and losses. We cannot believe this result to corporate, union, and public pension plans and other FOF investors is justified in light of the lack of practical ability of any investor to engage effectively in spinning through a FOF investment.

Therefore, although as noted above we believe that the lack of control and knowledge over Portfolio Fund brokers should be sufficient to demonstrate that collusive spinning cannot take place through a FOF, if FINRA does not find that argument decisive, then we would like to propose the following alternative. We propose that FINRA provide relief from the prohibitions of Rule 5131(b) to any FOF that:

(1) complies with the three prongs set forth above and

(2) does not invest more than 10% of its assets in any Portfolio Fund at the time of investment, and takes prompt action to reduce its exposure to 10% or less of any Portfolio Fund that (through performance or otherwise) becomes more than 10% of the FOF's assets,

(3) except to the extent that more than 25% of the FOF is comprised of investors who, individually, own more than 10% of the FOF, are eligible to receive new issues, and are Rule 5131 restricted persons.

In other words, a FOF that meets the test set forth above would not have to obtain Rule 5131(b) representations from any beneficial owner of the FOF that does not own more than 10% of the FOF or that is not eligible to participate in new issues. If a FOF meets those prongs, then not only will FINRA have assurance that no investor in the FOF has knowledge or control of the broker used by a Portfolio Fund (and thus no ability to collude), but also that any indirect economic benefit that an investor in a FOF could derive from any particular new issue investment by a Portfolio Fund would be extremely minor, and vastly outweighed by the economic risk/exposure the FOF investor has to other investments through the FOF. Indeed, under a scenario where an investor owns 10% of a FOF, and the FOF owns 10% of a Portfolio Fund, even assuming the Portfolio Fund takes a 10% exposure to a new issue trade (an unlikely, hugely concentrated position), the FOF investor would only have a 0.1% exposure to the new issue allocation. It would be economically irrational for any Rule 5131 restricted investor to take on a 99.9% FOF exposure for a 0.1% new issue exposure. FINRA 5131(b) should not apply, and the FOF should not be required to obtain Rule 5131(b) representations from, any investor who does not own more than 10% of the FOF under these circumstances.

We greatly appreciate your consideration of the foregoing issues and recommendation. We would, of course, be happy to amend this recommendation if there are particular concerns you believe it does not address. I will call you in the near future to discuss this recommendation, but in the meantime if you have any questions, please do not hesitate to call me at (312) 595-7955 or email me at grobbins@mesirowfinancial.com.

Sincerely,

Gregory J. Robbins
Senior Managing Director and General Counsel
Mesirow Advanced Strategies, Inc.

Alternative Investment Management Association

Richard G. Ketchum
Chairman and Chief Executive Officer
The Financial Industry Regulatory Authority
1735 K Street
Washington DC, 20006
USA

Sent by email to: rick.ketchum@finra.org

3 August 2011

Dear Mr Ketchum,

Financial Industry Regulatory Authority (FINRA) Rule 5131(b) (new issue allocations and distributions — 'spinning')

In this letter, the Alternative Investment Management Association (AIMA)[1] would like to raise its members' concerns about the application of a rule that the Financial Industry Regulatory Authority (FINRA) has recently introduced regarding the practice of 'spinning' (FINRA Rule 5131(b)). The rule is due to take effect on 26 September 2011.

We are also writing as a follow-up to a letter dated 10 June 2011 from Mesirow Advanced Strategies, Inc. ("Mesirow") to Gary Goldsholle, Vice-President and Associate General Counsel, Office of General Counsel, FINRA, regarding FINRA Rule 5131(b) and its application to direct trading hedge funds ("Direct Funds") and funds of hedge funds ("FoFs,") (together, "Investment Funds").

AIMA's comments

AIMA is a firm believer in FINRA's goal of protecting the integrity of the markets, and we support the implementation of market regulation that is effective and targeted. We, therefore, appreciate and applaud FINRA's efforts to attempt to curb "spinning" practices through the implementation of Rule 5131(b). Rule 5131(b), which prohibits allocations of new issues to executive officers and directors of current (and certain former or prospective) investment banking clients of a FINRA member, is designed to ensure that investment banking clients "have no involvement or influence, directly or indirectly, on the new issue allocation decisions of the [FINRA] member"[2]. We agree with FINRA's position that "[b]ecause such persons are often in a position to hire FINRA [members] on behalf of the companies they serve, allocating new issues to such persons creates the appearance of impropriety and has the potential to divide the loyalty of the agents of the company (i.e., the executive officers and directors) from the principal (i.e., the company) on whose behalf they must act"[3].

Only FINRA members (e.g., broker-dealers) are required by regulation to comply with Rule 5131(b). However, for a broker to comply with Rule 5131(b), it requires each Investment Fund to which it makes new issues allocations to contractually represent that the Investment Fund is in compliance with Rule 5131(b). We agree with Mesirow that this indirect application of Rule 5131(b) to Investment Funds is unlikely to further FINRA's very important interests in prohibiting spinning abuses. At the same time, though, Rule 5131(b) will potentially cost the Investment Funds industry and its investors significant amounts of time and money to implement. We are, therefore, requesting, on behalf of Investment Funds, that FINRA provide:

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in over 40 countries.

[2] FINRA Regulatory Notice 10-60, Approval of New Issue Rule, November 2010, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122490.pdf

[3] Ibid.

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: www.aima.org

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(1) exemptive relief from the application of Rule 5131(b); and

(2) guidance as to the proper implementation of the 25% de minimis exemption contained in Rule 5131(b) (the "De Minimis Exemption").

1. Request for exemptive relief from the application of Rule 5131(b)

By their nature, Investment Funds are not effective tools for persons who may be restricted under Rule 5131(b) to influence a FINRA member firm's allocations of new issues.

The investment adviser of a Direct Fund typically directs trades and selects the broker that will be used for executing those trades, without prior notice to, or consultation with, any beneficial owner of that Direct Fund. Brokers to Direct Funds do not normally know the identity of the beneficial owners of the Direct Funds. Thus, investors in a Direct Fund and the brokers to that Direct Fund do not have a practical opportunity to act in a manner inconsistent with the purposes of FINRA Rule 5131(b) because they do not know each others' identity or which broker the Direct Fund will use for any particular trade.

At the FoF level, the opportunity for new issue allocations to be made in a manner inconsistent with the purpose of Rule 5131(b) is even more remote. A FoF typically invests in several Direct Funds and/or managed accounts advised by unaffiliated investment advisers. For example, a typical FoF may have investments in anywhere from 25 to 70 Direct Funds, depending on the strategy employed by the FoF. None of the investment advisers to those Direct Funds is typically affiliated with the FoF's investment adviser. Investors in a FoF typically do not have any authority over determining into which Direct Funds the FoF will be invested and are not provided prior notice when the investment adviser to the FoF is going to invest in a new Direct Fund, redeem from an existing Direct Fund, or rebalance investments among Direct Funds. Instead, allocations to, redemptions from and reallocations among Direct Funds are made regularly by the FoF's investment adviser without input from the investors in the FoF. Even when an investor in a FoF may receive reports as to which Direct Funds the FoF invests in, neither the FoF's investment adviser nor the investors in the FoF have any involvement in the decision by any Direct Fund regarding which broker such Direct Fund will use in general or for any particular trade (including new issues investments), nor do they have the ability to direct which broker any Direct Fund will use. Additionally, Direct Funds typically utilise multiple brokers and change brokers regularly. Neither the Direct Funds nor the investment advisers of the Direct Funds advise their investors (including FoFs) in advance of changes in brokers, or of what broker may be used for any particular trade, and by extension such information is not communicated to investors in the FoFs invested in such Direct Funds.

Moreover, because most Investment Funds are pooled investment vehicles with diversified ownership and diversified holdings, it would be economically irrational for an investor in an Investment Fund to seek the benefit of new issue allocations in exchange for investment banking business in this way. The gains or losses to be realised on that new issue would be realised by the investor only in the amount of its proportional ownership of the Investment Fund. Moreover, the investor would be required to take exposure to all of the other non-new issues investments of the Investment Fund in order to gain this minimal, proportional exposure to the new issue. Clearly, that inefficiency is exacerbated in the context of FoFs, where an individual investor's proportional exposure to any particular new issue is even more minimal.

As already noted, the goal of Rule 5131(b) is to prevent an executive officer or director of a covered company from colluding with a broker to receive new issues allocations. However, given that investors in a Direct Fund do not even know which brokers that Direct Fund will use for any given trade, let alone direct which brokers that Direct Fund uses or will use; and investors in a FoF are even further removed from any such information, often not knowing in what Direct Funds the FoF is invested; there is simply no opportunity for action inconsistent with the intent of Rule 5131(b) through Investment Funds (and especially through FoFs). Because it would be practically impossible for an investor in an Investment Fund to try to collude with any particular broker in the hopes of getting a new issue allocation made to that Investment Fund (or, in the case of FoFs, to a Direct Fund in which a FoF invests) in instances where the investor has no knowledge or control over the brokers to be used by

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: www.aima.org

Registered in England as a Company Limited by Guarantee, No. 4437037. VAT registration no: 577 5913 90. Registered Office as above

the Investment Fund (or, in the case of FoFs, by any Direct Fund in which the FoF invests), we would propose that FINRA provide exemptive relief to Investment Funds by amending Rule 5131(b)(2) as follows (*new language is italicized*):

> "(2) The prohibitions in this paragraph shall not apply to allocations of shares of a new issue to
>
> *(A)* any account described in Rule 5130(c)(1) through (3) and (5) through (10),
>
> *(B)* 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, *or*
>
> *(C) any account owned by an entity that (I) does not disclose to its beneficial owners that participate in new issues, or permit them to direct, the broker which the account will use for any trade and (II) receives representations and warranties from each of its beneficial owners that participate in new issues that the beneficial owner has not invested in the entity to avoid the application of Rule 5131(b).*"

An Investment Fund that complies, and represents to its brokers, or, in the case of FoFs, to the Direct Funds in which it invests, that it is in compliance with this proposed new language for Rule 5131(b)(2)(C) should be treated by those brokers or Direct Funds (as applicable) as an unrestricted person for Rule 5131(b) purposes.

2. Request for guidance on the proper implementation of the De Minimis Exemption

Rule 5131(b)(2) provides that "[t]he prohibitions in [Rule 5131(b)] shall not apply to allocations of shares of a new issue 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".

We appreciate FINRA's efforts in providing that the De Minimis Exemption was narrowly tailored to cover only the executive officers and directors of a public company or a covered non-public company (as defined in FINRA Rule 5131(e)) (each a "Covered Company"), rather than broadly restricting from all new issues trades all executive officers and directors of all Covered Companies. However, the lack of guidance from FINRA regarding how the De Minimis Exemption should be implemented has created confusion and uncertainty among investment advisers to Investment Funds on how to appropriately comply with it. The confusion and uncertainty in the industry regarding the De Minimis Exemption has created a situation where there is apparently no consistent understanding of Rule 5131(b) by investment advisers, following the advice of their legal and regulatory counsels. In fact, many investment advisers are implementing Rule 5131(b) in ways that we believe are much more onerous than what was intended by FINRA – this could have a significant negative impact on the Investment Funds industry.

We, therefore, request that FINRA clarify: (a) what representation Investment Funds need to obtain from their investors, and need to give to brokers and, in the case of FoFs, to Direct Funds, to comply with the De Minimis Exemption; and (b) how the 25% threshold in the De Minimis Exemption is calculated.

a. Representation for De Minimis Exemption

Our view, which we understand is consistent with the approach taken by many investment advisers of Investment Funds, law firms, and other industry participants, is that an entity complies with the De Minimis Exemption if it is able to represent that it is:

> "an entity that allocates, in the aggregate, no more than 25% of profits or losses attributable to new issues received by that entity to (i) executive officers and directors, and persons materially supported by executive officers and directors, of any one public company or covered non-public

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: www.aima.org

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Alternative Investment Management Association

company (as defined in FINRA Rule 5131(e), or (ii) entities that provide a representation that they allocate, in the aggregate, no more than 25% of profits or losses attributable to new issues received by such entities to executive officers and directors, and persons materially supported by executive officers and directors, of any one public company or covered non-public company (as defined in FINRA Rule 5131(e)."

Any entity, including an Investment Fund, that complies with that representation would be unrestricted by exemption for Rule 5131(b) purposes. Therefore, brokers and Investment Funds would treat that entity as unrestricted to the same extent as they treat all other exempt accounts under Rule 5131(b) (for example, benefits plans under the Employee Retirement Income Security Act of 1974, as amended, that are qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended, and that are not sponsored solely by a broker-dealer). That entity would be eligible to receive its allocable share of new issues without any carve-down or reduction on that allocation.

b. Calculation of 25% Threshold

With respect to the calculation of the 25% threshold in the De Minimis Exemption, it is our view that an entity:

(a) should perform the 25% calculation separately for each Covered Company;

(b) should not count as restricted investors (i.e., should exclude from the numerator of the calculation) any of its beneficial owners that claim exemption under Rule 5131(b), including pursuant to the De Minimis Exemption (each, an "Exempt Investor"), because those beneficial owners are not restricted investors under Rule 5131(b) (they are exempt);

(c) should not have to obtain Covered Company information from Exempt Investors because (as discussed under item (b) above) Exempt Investors are not restricted investors under Rule 5131(b) so their Covered Company information would not be used for determining the entity's Rule 5131(b) status; and

(d) should obtain Covered Company information from each of its beneficial owners that receive new issues allocations and that either are not Exempt Investors or are purely unrestricted under Rule 5131(b), and should use that information to calculate its percentage ownership by restricted investors under Rule 5131(b) (i.e., should include that information in the numerator of the calculation).

We strongly believe that the approach described above is a reasonable interpretation of Rule 5131(b) and an appropriate mechanism to address spinning concerns, while alleviating the confusion and substantive operational difficulties associated with requiring an entity to obtain Covered Company information from each of its beneficial owners, including Exempt Investors.

We greatly appreciate your consideration of the foregoing request for exemptive relief from, and guidance on, Rule 5131(b). We would, of course, be happy to submit further, or amend, recommendations if there are particular concerns that you believe we have not addressed. If you have any questions, please do not hesitate to contact me (abaker@aima.org), Jiří Król (jkrol@aima.org) or Daniel Measor (dmeasor@aima.org).

Yours sincerely,

Andrew Baker
Chief Executive Officer

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: www.aima.org

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MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

August 19, 2011

Marc Menchel
Executive Vice President and General Counsel for Regulation
Financial Industry Regulatory Authority
1735 K Street, NW
Washington DC, 20006-1506

Re: FINRA Rule 5131, New Issue Allocations and Distributions

Dear Mr. Menchel:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments in response to FINRA Rule 5131, New Issue Allocations and Distributions, which is designed to prohibit inappropriate activity related to the allocation and distribution of new issues, including "spinning" and *quid pro quo* arrangements.[2]

MFA strongly agrees with the objective of Rule 5131 to promote public confidence in the initial public offering process by preventing conflicts of interest or impropriety by employees of public and non-public companies in connection with the allocation of new issues. MFA members are active investors and significant stakeholders in such companies, and depend on fair and open markets to conduct their investing activity, and honest and ethical management to act in all investors' best interests. Accordingly, we share FINRA's goals to ensure that the IPO process is conducted fairly and without any undue influence, and that corporate management makes decisions for the benefit of shareholders.

Initial public offerings are a critical source of funding for private companies to expand their businesses, and as participants in the IPO market, hedge funds and other investors play an important role in allocating capital to these companies. In light of this activity, many hedge fund managers have assessed the effect of the anti-spinning provision in Rule 5131 on their participation in new issue allocations, and in particular the scope of the *de minimis* exemption, upon which many

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[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] *See* Securities Exchange Act Release No. 63010 (Sept. 29, 2010), 75 Fed. Reg. 61541 (Oct. 5, 2010); Approval of New Issue Rule, FINRA Regulatory Notice 10-60 (November 2010), available at: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122490.pdf.

managers will seek to rely.[3] As described below, we are concerned that the provision could reduce hedge funds' willingness to invest in IPOs in a manner that we do not believe FINRA intended. We are hopeful that interpretive guidance clarifying the exemption would largely address these concerns.

Application of Anti-Spinning Provision to Hedge Funds

We appreciate the policy basis for the anti-spinning prohibition, and support the goal of preventing inappropriate activity by covered employees of public and non-public companies in connection with the IPO process. We also agree that the Rule should be designed to prevent individuals from seeking to avoid the restrictions by obtaining new issue allocations indirectly, such as through an ownership interest in a pooled investment vehicle.

Nevertheless, the structure and investment activity of most hedge funds make it unlikely that an individual could seek to use an investment in a fund to engage in a spinning arrangement. Hedge funds are managed by an investment adviser that is responsible for investment decisions, including the selection of brokers and determinations to participate in an initial public offering.[4] Fund investors are generally not affiliated with the manager, do not influence or have control over the manager, are not involved in choosing fund investments, and typically have only limited transparency as to the fund's activities and investment positions, for example by receiving periodic summary information on a delayed basis from the manager. In the case of hedge funds with investors that themselves are pooled investment vehicles (*e.g.*, funds of hedge funds), the underlying beneficial owners of such investors are even further removed from the fund manager than direct investors, and have even more limited knowledge of a fund's activities, since they do not receive information directly from the manager. This structure would preclude a hedge fund investor from evading the anti-spinning provision absent the consent and participation of the manager.

In addition, hedge funds typically have a diversified range of investors and allocate their capital across a broad portfolio of assets, so that any profit or loss allocation from a single investment, including a new issue, would have only a small effect on the overall returns of each investor. Investments in hedge funds are also generally subject to restrictive liquidity terms, with redemptions typically permitted only on a quarterly basis, and in many cases are subject to other restrictions, such as a minimum one-year investment period. As a result of these features, an investor typically would only have an indirect, diluted financial interest in any specific new issue allocation, and could not use a hedge fund investment to obtain exposure only to a single allocation.

Together, these factors significantly reduce the risk of spinning by a hedge fund investor through an investment in a hedge fund, and we encourage regulators to take them into consideration in determining how a hedge fund should comply with Rule 5131.

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[3] Rule 5131(b) prohibits FINRA members from allocating shares of a new issue to an account in which an executive officer or director of a public company, or a covered non-public company ("covered employees"), has a beneficial interest if the company is, or is expected to be, an investment banking client of the firm.

Paragraph (b)(2) exempts new issue allocations to, among others, an account in which the beneficial interests of executive officers and directors of the company in total do not exceed 25% of the account.

[4] Typically, however, individuals affiliated with the investment manager, including its owners and officers, will also invest in the fund as a means of aligning their interests with fund investors.

We appreciate that the Rule provides exemptions from the anti-spinning provision for certain types of entities,[5] as well as accounts where the ownership interest of covered employees, such as in a pooled investment vehicle, is small and does not give rise to the types of concerns underlying the provision. The list of exempted entities does not include hedge funds, and managers will therefore need to comply with the *de minimis* exemption to obtain new issue allocations. In its current form, however, the *de minimis* exemption has resulted in considerable confusion and uncertainty in the hedge fund industry.[6] Indeed, in the short time since the rule became final, law firms have offered various divergent and inconsistent interpretations of the steps a manager would need to take to rely on the exemption. Some of these interpretations are likely to lead hedge fund managers to impose overly broad restrictions on allocating new issues to their funds to both comply with the exemption and receive new issue allocations.

An important concern is that, according to some analyses, to rely on the exemption a manager would need to regularly collect and calculate information about the business affiliations of not only a fund's direct investors, but also the affiliations and ownership interests of individuals who invest through unaffiliated pooled vehicles (*e.g*., beneficial owners of a fund of hedge funds). However, for various legitimate reasons, including logistical burdens, investor privacy and confidentiality concerns, unaffiliated investment managers, banks, investment banks and other intermediaries that invest in hedge funds, generally do not share detailed information about their investors with managers of funds in which they invest. As a result, hedge fund managers generally do not have access to information about these types of indirect investors, and are often not in a position to gather or request data about them. The difficulty this creates for complying with the *de minimis* exemption by looking through to indirect investors is compounded by the fact that these indirect investors regularly purchase and redeem interests in the pooled vehicle investors, and may change their employment status, so that a hedge fund manager would need to calculate the number of covered employees on an ongoing basis. It generally is not possible for a manager to gather this information in the short time period between learning about a new issue and requesting an allocation, and even if a manager could gather such information, the structure of hedge funds would not generally permit a manger to allocate the applicable new issue solely to persons that are not covered employees with respect to such allocation.

For these reasons, managers will not be able to properly identify covered employees in pooled vehicle investors, and many intend either to prohibit pooled vehicle investors in a hedge fund from all new issue allocations if there are any restricted investors in the pooled vehicle, or only allocate new issues to a pooled vehicle investor if it will not allocate any new issue to a restricted investor, regardless of the covered company of the investor. In some cases, hedge fund managers may choose to not participate at all in a new issue allocation. If managers across the industry adopt these or similar approaches, hedge fund participation in initial public offerings is likely to decline, thereby decreasing investor demand for new issues and impairing an important source of capital to growing companies.

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[5] The prohibitions in Rule 5131(b) do not apply to allocations of shares of a new issue to accounts described in Rule 5130(c)(1) through (3) and (5) through (10).

[6] *See e.g.*, Letter from Andrew Baker, CEO, Alternative Investment Management Association, to Richard G. Ketchum, CEO, FINRA, dated Aug. 3, 2011.

For these reasons, we recommend that FINRA provide additional guidance that would allow a pooled investment vehicle to rely on the *de minimis* exemption from the anti-spinning provision under the following conditions:

(i) The pooled investment vehicle meets the definition of "private fund" in Section 202(a)(29) of the Investment Advisers Act of 1940, as an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940, but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act; and

(ii) Each direct investor in the pooled investment vehicle either:

a. Can rely on an exemption under Rule 5131(b)(2), including the *de minimis* exemption, or

b. Owns interests less than or equal to 25% of the pooled investment vehicle, and the manager of the pooled investment vehicle has no knowledge that the investor was established to evade the anti-spinning prohibitions in Rule 5131(b).

This guidance would be consistent with the intent of the Rule, and help ensure that hedge funds and funds of hedge funds do not become vehicles for circumventing the Rule. At the same time, the guidance would enable these entities to participate in IPOs instead of concluding that such participation was impracticable.

* * * * * * *

MFA appreciates the opportunity to provide these comments to FINRA in response to the Rule. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Newell, Assistant General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: Gary L. Goldsholle, Vice President and Associate General Counsel, FINRA

MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

October 4, 2011

Mr. Marc Menchel
Executive Vice President and General Counsel for Regulation
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Rule 5131(b), New Issue Allocations and Distributions — Spinning

Dear Mr. Menchel:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide additional comments in response to Financial Industry Regulatory Authority ("FINRA") Rule 5131(b), New Issue Allocations and Distributions — Spinning ("Rule 5131"). Joining MFA as an author of this letter is Schulte Roth & Zabel LLP ("SRZ"),[2] a member of MFA. References to "we" and "our" in this letter refer to MFA and SRZ.

This letter follows several communications between financial industry participants and representatives and FINRA regarding Rule 5131 and its application to direct trading hedge funds ("Direct Funds") and funds of hedge funds ("FoFs", and together with Direct Funds, "Investment Funds").[3] As previously expressed in the MFA Letter, we strongly agree with the objective of Rule 5131 to promote public confidence in the initial public offering process by preventing conflicts of interest or impropriety by employees of public and non-public companies in connection with the allocation of new issues. We join Mesirow and AIMA in applauding FINRA's efforts to attempt to curb "spinning" practices through the implementation of Rule 5131, which prohibits allocations of new issues to executive officers

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] SRZ is a multidisciplinary law firm with offices in New York, Washington, D.C., and London. As one of the leading law firms serving the financial services sector, SRZ regularly advises clients on investment management, corporate and transactional matters, and serves as counsel on securities regulatory compliance, enforcement and investigative issues. SRZ represents more than 200 investment management companies and thousands of investment funds.

[3] The communications include: (i) a letter dated August 19, 2011, from MFA to you (the "MFA Letter"); (ii) a letter dated June 10, 2011, from Mesirow Advanced Strategies, Inc. ("Mesirow") to Mr. Gary Goldsholle, Vice-President and Associate General Counsel, Office of General Counsel, FINRA (the "Mesirow Letter"); and (iii) a letter dated August 3, 2011, from the Alternative Investment Management Association Limited ("AIMA") to Mr. Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA (the "AIMA Letter").

and directors, and persons materially supported by any such executive officer or director ("Covered Persons"), of a public company or a covered non-public company (each, a "Covered Company") that is a current (or, under certain circumstances, former or prospective) investment banking client of a FINRA member.

The Problem

As you know, the financial industry has generally interpreted the *de minimis* exemption of Rule 5131 (the "De Minimis Exemption") as operating in a manner similar to the manner in which the Rule 5130 *de minimis* exemption operates: requiring accounts (*e.g.*, Direct Funds) to count the direct and indirect beneficial interests of Covered Persons when calculating the aggregate beneficial interests of Covered Persons of a particular Covered Company. We contend that inclusion by a Direct Fund of the indirect beneficial interests of Covered Persons in its *de minimis* calculation does not advance the policy objectives of Rule 5131 and, as a practical matter, forces the Investment Funds to choose between crippling administrative complexity and restricting from new issues participation investors who should be able to participate in new issues under Rule 5131, but cannot due to logistical considerations. In fact, SRZ is not aware of any of its FoF clients that have been willing to provide to the Direct Funds in which they invest information regarding the Covered Company affiliations of their Covered Person beneficial owners. The most that these FoFs will provide is a representation that, based on their own diligence, they qualify for the De Minimis Exemption.

The inability to obtain the specific Covered Company information from the FoFs creates a dilemma for the Direct Funds. Because any Covered Person of a Covered Company who invests in a Direct Fund could also be an investor in a FoF that invests in the Direct Fund, the Direct Fund, in the absence of the requisite information from the FoFs, is forced either to prohibit the participation in new issues by direct Covered Person investors in the Direct Fund or prohibit the participation in new issues by FoF investors in the Direct Fund that allow any of their Covered Person beneficial owners to participate in new issues. For example, if Covered Persons of Apple Inc. owned 15% of the interests in a Direct Fund, and a FoF owned 50% of the interests in the same Direct Fund, and those same Covered Persons of Apple Inc. owned 20% of the FoF (something the Direct Fund will rarely know), then the Covered Persons related to Apple Inc. would beneficially own, in the aggregate, 25% of the Direct Fund (with a 15% direct interest in the Direct Fund and a 10% indirect interest through the FoF that owns 50% of the Direct Fund). Because of the absence of information from the FoFs, Direct Funds that are SRZ clients are simply not allowing direct Covered Person investors to participate in new issues or, at the very least, are strictly limiting their participation.

The Proposal

Given this dilemma, we propose that FINRA generally permit an account to count only its direct beneficial owners for purposes of the De Minimis Exemption and not look up the chain of ownership to all indirect beneficial owners.

To begin with, the structure and investment activity of most Investment Funds make it practically impossible for an individual to engage in a spinning arrangement through a FoF or other entity investing in a Direct Fund. To engage in a spinning arrangement:

(i) a broker-dealer would have to know (a) the identity and company affiliation of direct Covered Person investors in a Direct Fund, (b) the identity of FoF or other entity investors in the Direct Fund and (c) the identity and company affiliation of Covered Person investors in the FoF or other entity investors;

(ii) the Covered Person would have to know the identity of the broker-dealer allocating new issues to the Direct Fund; and

(iii) the Covered Person would have to have control over the selection of the broker-dealer.

These circumstances are simply not present in the typical Direct Fund/FoF context because: (i) broker-dealers to Direct Funds do not normally know the identity of the beneficial owners of the Direct Fund, including any FoF or other entity investors therein; (ii) beneficial owners of Direct Funds do not normally know the identity of the broker-dealer used by the Direct Fund for any particular trade; and (iii) a Direct Fund is managed by an investment adviser that is responsible for investment decisions, including the selection of broker-dealers and determinations to participate in an initial public offering, without prior notice to, or consultation with, any beneficial owner of that Direct Fund. Given how remote the opportunity is for an investor in a FoF to influence the choice of the Direct Fund's broker-dealer, the likelihood that spinning is taking place is truly minute.

Proposed Limited Look-Through Approach

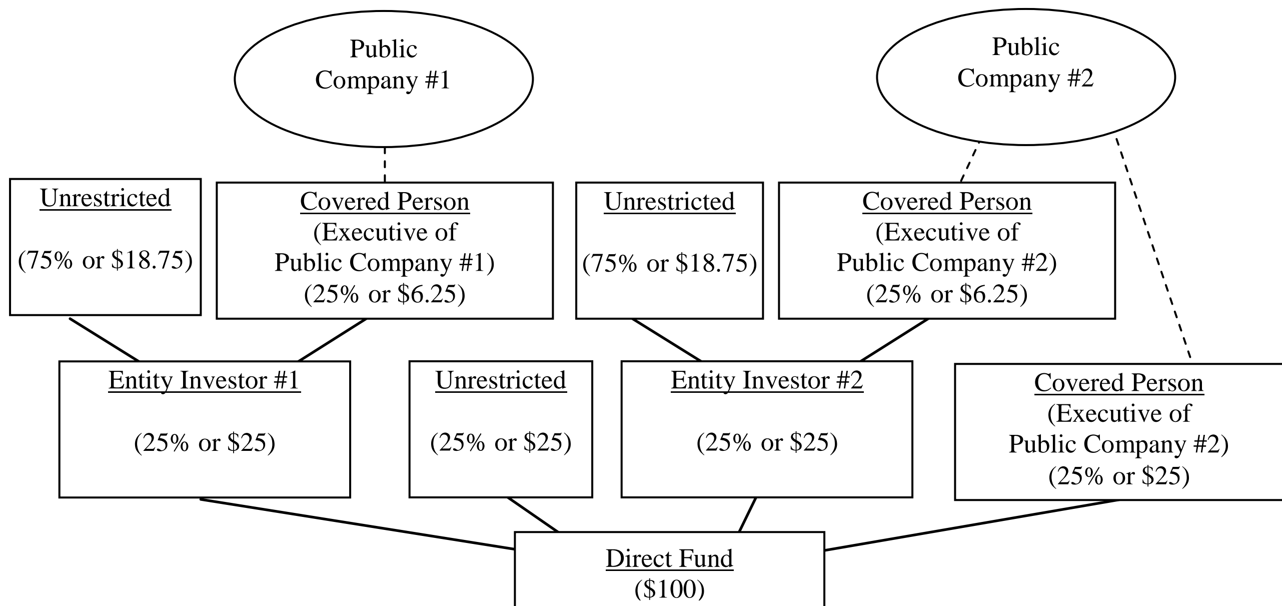
Much of the compliance burden would be relieved, and the inequitable exclusion of Direct Fund's Covered Person beneficial owners would not be necessary, if FINRA adopts the view that, for the purpose of the De Minimis Exemption, a Covered Person is generally deemed to have a beneficial interest only in the entity in which he or she is directly invested. Thus, Direct Funds would conduct their diligence at the Direct Fund level, and FoFs would conduct their diligence at the FoF level. A Direct Fund would not look through an entity investor investing in it unless: (i) such entity was formed for the specific purpose of investing in the Direct Fund; or (ii) such entity directly or indirectly controls, is controlled by, or is under common control with, the Direct Fund. A FoF (or any other account) would undertake the same analysis with respect to an entity investor that invested in it. As a result, a Direct Fund seeking to qualify for the De Minimis Exemption would conduct its due diligence at the Direct Fund level, and could rely on a representation from any FoF investors that they qualify for the De Minimis Exemption. This approach is relatively simple to understand and apply.

Comparison of Allocation Policy Options Under Current and Proposed Interpretation

To illustrate how the limited look-through approach would compare to the current approach, assume that a Direct Fund has $100 million in assets, which are directly owned by

two entity investors (25% each), an unrestricted investor (25%), and a Covered Person (25%) who is an executive of a public company ("Public Company #2"). Each entity investor is beneficially owned by a Covered Person (25%) and an unrestricted investor (75%). One of the entity investors ("Entity Investor #2") is owned by an executive of Public Company #2, while the other entity investor ("Entity Investor #1") is owned by an executive of a different public company ("Public Company #1"). Assume for these purposes that no beneficial owner of the Direct Fund is a restricted person under Rule 5130 and that none of the carve-outs from the proposed limited look-through interpretation would apply.

The following diagram illustrates the facts above and shows each beneficial owner's *pro rata* share of profits and losses:



Under the De Minimis Exemption as currently interpreted, the Direct Fund would generally have to choose among: (i) restricting the direct Covered Person investor and allocating the new issues profits *pro rata* among Entity Investor #1, Entity Investor #2 and the unrestricted investor; (ii) restricting Entity Investor #1 and Entity Investor #2 and allocating the new issues profit 75% to the unrestricted investor and 25% to the direct Covered Person investor; or (iii) assuming the requisite information was available, looking through Entity Investor #2, aggregating the direct and indirect beneficial ownership of executive of Public Company #2, and allocating accordingly.

However, if, for purposes of the De Minimis Exemption, owners of an entity were generally deemed to have a beneficial interest only in the entity in which they directly invest, the allocation options become much more simple. Under our suggested interpretation, assuming that FoF investors in a Direct Fund could represent that they qualify for the De Minimis Exemption and that all Covered Persons that directly invested in the Direct Fund also

come within the De Minimis Exemption, the Direct Fund could allocate new issues profit *pro rata* among all investors.

This approach would be consistent with the intent of Rule 5131, and would help ensure that Direct Funds and FoFs do not become vehicles for circumventing the Rule. At the same time, it would enable these entities to participate in IPOs instead of strictly limiting such participation or concluding that participation was impracticable.

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We appreciate the opportunity to provide these comments to FINRA in response to Rule 5131. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

Cc: Gary L. Goldsholle, Vice President and Associate General Counsel, FINRA

EXHIBIT 5

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

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

* * * * *

5131. New Issue Allocations and Distributions

(a) through (e) No Change.

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

.01 No Change.

.02 [Annual] Written Representations.

(a) Annual Representation. For the purposes of [paragraph] Rule 5131(b), a member may rely upon 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.

(b) Indirect Beneficial Owners. For the purposes of Rule 5131(b), a member may rely upon a written representation obtained within the prior 12 months from a person authorized to represent an account that does not look through to the beneficial owners of any unaffiliated private fund invested in the account, that such unaffiliated private fund:

(1) is managed by an investment adviser;

(2) has assets greater than $50 million;

(3) owns less than 25% of the account and is not a fund in which a single investor has a beneficial interest of 25% or more;

(4) does not have a beneficial owner that also is a control person of such fund's investment adviser; and

(5) was not formed for the specific purpose of investing in the account.

An unaffiliated private fund is a "private fund," as defined in Section 202(a)(29) of the Investment Advisers Act, whose investment adviser does not have a control person in common with the investment adviser to the account. A control person of an investment adviser is a person with direct or indirect "control" over the investment adviser, as that term is defined in Form ADV.

(c) 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] Rule 5131(b) in its files for at least three years following the member's allocation to that account.

.03 No Change.

* * * * *