

Capital Formation

FINRA Requests Comment on FINRA Rules Impacting Capital Formation

Comment Period Expires: May 30, 2017

Executive Summary

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Broker-dealers play a vital role in helping businesses raise capital through the securities markets, and as a self-regulatory organization (SRO) for broker-dealers, FINRA has a variety of rules, operations and administrative processes that address their capital-raising activities.

FINRA recently announced a new initiative—called FINRA360—to evaluate various aspects of its operations and programs to identify opportunities to more effectively further its mission. As part of this initiative, FINRA is requesting comment on the effectiveness and efficiency of its rules, operations and administrative processes governing broker-dealer activities related to the capital-raising process and their impact on capital formation.

Questions regarding this *Notice* should be directed to:

- ▶ Joseph Price, Senior Vice President and Counsel, Corporate Financing/ Advertising Regulation, at (240) 386-4642 or joseph.price@finra.org;
- ▶ James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270 or jim.wrona@finra.org; or
- ▶ Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013 or jeanette.wingler@finra.org.

April 2017

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Investment Banking
- ▶ Legal
- ▶ Research
- ▶ Senior Management
- ▶ Trading

Key Topics

- ▶ Capital Acquisition Brokers
- ▶ Crowdfunding
- ▶ Direct Participation Programs
- ▶ Funding Portals
- ▶ Investment Banking
- ▶ JOBS Act
- ▶ Market Making
- ▶ Research
- ▶ Trading
- ▶ Unlisted REITS

Referenced Rules

- ▶ Capital Acquisition Broker Rules
- ▶ FINRA Rules 1060, 2241, 2242, 2310, 4518, 5100 Series, 5250 and 6432
- ▶ Funding Portal Rules
- ▶ JOBS Act
- ▶ Regulation Crowdfunding
- ▶ Regulation M
- ▶ SEA Rule 15c2-11

Action Requested

FINRA encourages all interested parties to comment on this *Notice*. Comments must be received by May 30, 2017.

- ▶ Comments must be submitted through one of the following methods:
 - ▶ Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process comments more efficiently, persons should use only one method to comment on this *Notice*.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.¹

Before becoming effective, any proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).²

Background & Discussion

FINRA is an SRO for the broker-dealer industry and is dedicated to investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets—including markets that support efficient capital formation.

Well-functioning securities markets can enable businesses of all sizes to access the capital necessary to fund and grow their operations, which can in turn create new jobs and promote economic growth and opportunity. Today, trillions of dollars in capital are raised by companies each year in both registered and unregistered U.S. securities offerings.³ And in recent years, particular attention has been paid to capital raising by small businesses, which represent more than 99 percent of employers in the United States and which create significant numbers of new jobs.⁴

FINRA members play a critical role in facilitating virtually every stage of the capital-raising process in these markets, such as by underwriting public offerings, advising companies on capital raising and corporate restructuring, acting as placement agents for sales of

unregistered securities, operating funding portals, and publishing research reports to educate and inform investors. For its part, FINRA promotes the capital-raising process through appropriately tailored rules applicable to its members that are designed to promote transparency and to establish important standards of conduct for the benefit of all market participants, including investors and issuers participating in offerings.

There have also been significant developments recently in the mechanisms companies use to raise capital through securities offerings. In response to directives from the Jumpstart Our Business Startups (JOBS) Act, for example, the SEC has adopted new rules to permit securities-based crowdfunding, updated the rules for exempt offerings under Regulation A and altered the requirements for private offerings under Regulation D. There have also been changes in the statutes and rules governing registered offerings, including initial public offerings (IPOs).

FINRA has taken a number of steps in recent years to modernize its regulation of members' participation in capital-raising activities. For instance, FINRA recently created the Capital Acquisition Broker (CAB) rule set, which allows members engaged in a limited range of corporate-financing activities—such as advising companies and private equity funds on capital raising and corporate restructuring—to elect to be governed by a targeted set of rules. In response to crowdfunding provisions of the JOBS Act,⁵ FINRA also created the Funding Portal Rules, which are a set of streamlined rules that are tailored to the limited scope of activities in which funding portals are permitted to engage under the JOBS Act and the SEC's Regulation Crowdfunding.⁶ In addition, FINRA amended FINRA Rule 5131, covering new issue allocations and distributions, to create an important exception to facilitate firm compliance when allocating shares of a new issue to the accounts of unaffiliated private funds.⁷ In FINRA Rule 5141, FINRA consolidated a number of rules regarding the sale of securities in fixed price offerings, creating a simplified rule that removed numerous outdated and redundant requirements, while at the same time maintaining core protections for investors and for the integrity of such offerings.⁸ Concurrent with the release of this *Notice*, moreover, FINRA is proposing amendments to FINRA Rule 5110, which prohibits unfair underwriting arrangements, to clarify and streamline its provisions.⁹

While these changes will increase efficiency and reduce unnecessary burdens on the capital-raising process without compromising important protections for issuers and investors, FINRA is interested in whether additional changes to these or other FINRA rules, operations or administrative processes would further enhance the capital-raising process while ensuring investor protections. Therefore, FINRA is requesting comment on the functioning of its rules that most directly apply to the capital-raising process and their effects on capital formation. An overview of these FINRA rules is set forth below. FINRA recognizes that other FINRA rules not listed here also could have an impact on capital formation and FINRA welcomes comment on them as well.¹⁰

FINRA notes, moreover, that its rules and programs are only part of a broader framework of securities laws, rules and regulations that govern or affect capital formation—such as the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), the JOBS Act, SEC rules, and rules of other SROs (*e.g.*, securities exchanges). Making changes to this broader regulatory framework is beyond FINRA’s control, and in certain cases FINRA rules are mandated by, or must conform to, specific statutory requirements or SEC rules. Nevertheless, FINRA welcomes comment on how its rules and programs relate to this broader regulatory framework and whether there are opportunities for FINRA to more closely align its rules and programs with the work of other regulators in a manner that promotes capital formation and preserves important investor protections.

CAB Rules

The recently approved CAB rules provide members engaged in a limited range of activities with flexibility in structuring their businesses while providing appropriate protections for investors and other market participants.¹¹ New applicants as well as existing members that meet the definition of a CAB may elect to be governed under the CAB rules. CABs are firms that engage in a limited range of activities, essentially advising companies and private equity funds on capital raising and corporate restructuring, and acting as placement agents for sales of unregistered securities to institutional investors under limited conditions.

Because CABs do not engage in many of the types of activities typically associated with traditional broker-dealers, FINRA determined that many of its rules should not apply to these firms, or should be modified to reflect their limited business activities. The CAB rule set is a separate, narrower set of rules to govern these members. Members that elect to be governed under the CAB rules are not permitted, among other things, to carry or maintain customer accounts, handle customers’ funds or securities, accept customers’ trading orders, or engage in proprietary trading or market-making.

Funding Portal Rules

The JOBS Act contains provisions that permit businesses to offer and sell securities through crowdfunding.¹² Funding portals that engage in crowdfunding on behalf of issuers must become a member of a national securities association.¹³ Under the JOBS Act and the SEC’s Regulation Crowdfunding, a funding portal may not: (1) offer investment advice or recommendations; (2) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; (3) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (4) handle investor funds or securities; or (5) engage in such other activities as the SEC, by rule, determines appropriate.

FINRA’s Funding Portal Rules are streamlined specifically for funding portals and to reflect the limited scope of activity permitted by funding portals while also maintaining investor protection. In addition, the notice requirements of FINRA Rule 4518 enable FINRA to keep track as to which of its members are engaging in crowdfunding activity.

FINRA Rule 2241 (Research Analysts and Research Reports) and Rule 2242 (Debt Research Analysts and Debt Research Reports)

FINRA's rules on research analysts and research reports on both the equity and debt sides are intended to foster objectivity and transparency in research and to provide investors with more reliable and useful information to make investment decisions.¹⁴ Certain requirements under these rules are derived from applicable statutory mandates and SEC interpretations of those mandates. In addition, in reviewing or modifying its research rules, FINRA seeks to ensure consistency and coordination with applicable SEC research rules (e.g., Regulation AC).

In a companion *Regulatory Notice*, FINRA is proposing amendments to Rule 2241 and Rule 2242 to create a limited safe harbor for eligible desk commentary prepared by sales and trading or principal trading personnel that may rise to the level of a research report.¹⁵ The proposed safe harbor would be subject to conditions, including compliance with a number of the Rule 2241 or Rule 2242 provisions, to mitigate the most serious research-related conflicts.

Rule 2241

Rule 2241 covers equity research reports.¹⁶ The rule implements provisions of Sarbanes-Oxley, which mandates separation between research and investment banking, proscribes conduct that could compromise a research analyst's objectivity, and requires specific disclosures in research reports and public appearances.¹⁷ The rule also applies some requirements imposed on members subject to the "Global Settlement"¹⁸ more broadly to all members.¹⁹

Rule 2241 requires disclosure of conflicts of interest in research reports and public appearances by research analysts, and limits conflicted conduct—investment banking personnel involvement in the content of research reports and determination of analyst compensation, for example—where the conflicts are too pronounced to be cured by disclosure.²⁰ The rule provides members flexibility in complying with its overarching requirement to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest without diminishing investor protection. Rule 2241 also exempts members with limited investment banking activity from the review, supervision, budget and compensation provisions in the rule.

Rule 2242

Rule 2242's requirements with respect to debt research are similar to the Rule 2241 framework with differences to reflect the operation of the debt markets. Rule 2242 adopts a tiered approach that provides retail debt investors with protections similar to those provided to equity investors under Rule 2241, with modifications to reflect differences in the trading of debt securities. At the same time, the rule provides broad exemptions for debt research distributed solely to institutional investors.

Rule 2242 differs from the equity research rule in three key respects. First, it sets out prohibited and permissible communications between debt research analysts and principal trading and sales and trading personnel, taking into account the need to ration a debt research analyst's resources among the multitude of debt securities, the limitations on price discovery in the debt markets, and the need for trading personnel to perform credit risk analyses with respect to current and prospective inventory. Second, the rule exempts debt research provided solely to institutional investors from many of the structural protections and prescriptive disclosure requirements that apply to research reports distributed to retail investors, but adds a "health warning" requirement. Third, in addition to the exemption for limited investment banking activity found in Rule 2241, Rule 2242 also contains an exemption for limited principal trading activity from the review, supervision, budget and compensation provisions in the rule related to principal trading activity.

FINRA Rule 2310 (Direct Participation Programs)

Rule 2310 addresses underwriting terms and arrangements in public offerings of direct participation programs (DPPs) and unlisted real estate investment trusts (REITs) (collectively, Investment Programs).²¹ A DPP is a business venture designed to let investors participate directly in the cash flow and tax benefits of an underlying investment (*e.g.*, oil and gas programs and equipment leasing programs). REITs are investment vehicles for income-generating real estate that benefit from the tax advantages of a trust if they satisfy certain criteria in the Internal Revenue Code.

Due to the complexity of and risks associated with Investment Programs, Rule 2310 includes several provisions to promote investor protection. The rule also promotes fairness by prohibiting unfair and unreasonable compensation. Specifically, Rule 2310 requires that members participating in a public offering of an Investment Program meet certain requirements regarding underwriting compensation, fees and expenses, perform due diligence on the Investment Program, follow specific guidelines on suitability, and adhere to limits on non-cash compensation. The rule also prohibits members from participating in an Investment Program unless the issuer has agreed to disclose valuation-related information to investors.²²

FINRA Rule 5100 Series

The FINRA Rule 5100 series governs underwriting and related compensation received by FINRA members in securities offerings. Rules in this series are intended to ensure the integrity of the capital markets and to protect market participants, including investors and issuers participating in offerings.

Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements)

Rule 5110 prohibits unfair underwriting arrangements in connection with the public offering of securities. The rule was originally developed in 1991 in response to persistent problems with underwriters dealing unfairly with issuers. The rule provides for FINRA staff review of the underwriting terms and arrangements of a member that participates in a public offering. The staff reviews this information prior to the commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of the applicable FINRA rules.

In a companion *Regulatory Notice*, FINRA is proposing amendments to Rule 5110 to make substantive, organizational and terminology changes to the rule. These changes—which are intended to modernize the rule—should improve the administration of the rule and simplify its provisions. The proposal would retain the primary principle of the rule that a member or person associated with a member should not participate in a public offering in which the terms and conditions, including underwriting compensation, are unfair or unreasonable.

FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest)

Rule 5121 prohibits a member from participating in a public offering of its own securities unless the conflicts of interest are disclosed, and in certain circumstances, a qualified independent underwriter participates. Members also must comply with certain net capital, discretionary accounts and filing requirements.

FINRA Rule 5122 (Private Placement of Securities Issued by Members) and FINRA Rule 5123 (Private Placements of Securities)

FINRA also reviews offering documents and information members use in selling their own and other issuers' private placements.²³ Rule 5123 requires members to file with FINRA, within 15 calendar days of the date of first sale of a private placement, a private placement memorandum, term sheet or other offering document, or indicate that no such offerings documents were used. Rule 5122 requires members that offer or sell their own securities to file the private placement memorandum, term sheet or other offering document at or prior to the first time the documents are provided to any prospective investor. Rule 5122 also establishes standards on disclosure and the use of private placement proceeds.

FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Public Equity Offerings)

Rule 5130 is intended to promote investor confidence in the capital-raising process by ensuring that: (1) members make *bona fide* public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including members and their associated persons, do not take advantage of their insider position to purchase new issues²⁴ for their own benefit to the exclusion of public customers.

FINRA Rule 5131 (New Issue Allocations and Distributions)

Rule 5131 is intended to support public confidence in the IPO process by establishing requirements with respect to the allocation, pricing and trading of new issues. Among other things, the rule prohibits quid pro quo allocations and “spinning,”²⁵ and addresses the conduct of members and associated persons in the areas of book-building, new issue pricing, penalty bids, trading and waivers of lock-up agreements.

FINRA Rule 5141 (Sale of Securities in a Fixed Price Offering)

Rule 5141 protects the integrity of fixed price offerings²⁶ by ensuring that securities in such offerings are sold to the public at the stated public offering price or prices. The rule prohibits the grant of certain preferences (*e.g.*, selling concessions, discounts, other allowances, various economic equivalents) in connection with fixed price offerings of securities.

FINRA Rule 5150 (Fairness Opinions)

Rule 5150 requires specific disclosures and procedures addressing the potential conflicts of interest that may arise when a broker-dealer provides a fairness opinion in a change of control transaction, such as a merger or sale or purchase of assets. The disclosures required by the rule are aimed at informing investor shareholders of potential conflicts, such as whether a member has acted as a financial advisor to any party to the transaction that is the subject of the fairness opinion, and if so, whether it will receive compensation contingent on the successful completion of the transaction.

FINRA Rule 5160 (Disclosure of Price and Concessions in Selling Agreements)

Rule 5160 requires that selling syndicate agreements or selling group²⁷ agreements: (1) set forth the price at which securities are to be sold to the public or the formula by which such price can be ascertained; and (2) state clearly to whom and under what circumstances concessions, if any, may be allowed.

FINRA Rule 5190 (Notification Requirements for Offering Participants)

Rule 5190 sets forth the notice requirements applicable to all members participating in offerings of securities for purposes of monitoring compliance with the provisions of the SEC’s Regulation M. The rule is intended to ensure that FINRA receives pertinent distribution-related information from its members in a timely fashion.

FINRA Rule 5250 (Payments for Market Making)

Although Rule 5250 does not apply specifically to the capital-raising process, some members have indicated that it may unnecessarily limit certain arrangements that could create greater liquidity in some stocks and thus help facilitate capital formation.

Subject to enumerated exceptions, Rule 5250 prohibits members and their associated persons from accepting any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter thereof, for publishing a quotation or acting as a market maker in a security.²⁸ Exceptions include payment for *bona fide* services, including, but not limited to, payment for investment banking services such as underwriting compensation and fees. Rule 5250 is intended to ensure that a member acts in an independent capacity when publishing a quotation or making a market in an issuer's securities.

FINRA Rule 6432 (Compliance with the Information Requirements of SEA Rule 15c2-11)

Although Rule 6432 does not apply specifically to the capital-raising process, some members have indicated that the requirements it imposes on market makers may unintentionally create burdens on the quoting of stocks of smaller companies and thus impede capital formation.

Rule 6432 generally requires that, prior to initiating or resuming quotations in a non-exchange-listed security in a quotation medium, a member must demonstrate compliance with Rule 6432 and the applicable requirements for information maintenance under SEA Rule 15c2-11. Under Rule 6432, a member demonstrates compliance by filing a FINRA Form 211 at least three business days before the member's quotation is published or displayed in the quotation medium. FINRA processes a member's Form 211 submission once the required SEA Rule 15c2-11 documentation and related information has been submitted.

Form 211 largely requires members to provide, or reference, if electronic copies are available on EDGAR, the items of information listed in SEA Rule 15c2-11 applicable to the member's submission. In addition to the SEA Rule 15c2-11 items of information, a member is required to provide the price at which it intends to initiate quotations along with the basis upon which such price was determined. If a member's initial quotation does not include a priced entry, the member must supplement its prior filing with FINRA before initiating a priced entry. Rule 6432 also contains exceptions that parallel SEA Rule 15c2-11. A FINRA Form 211 filing is not required where a member is relying on an exception to or exemption from SEA Rule 15c2-11. However, under Rule 6432, if relying on the unsolicited customer order exception of SEA Rule 15c2-11(f)(2), a member must comply with the recordkeeping requirements of Rule 6432.01.

Trading Activity Fee (TAF)

Although the TAF does not apply specifically to the capital-raising process, some members have raised the question of whether the TAF may unintentionally impose disparate burdens on the trading of stocks of smaller companies.

The TAF is the one member regulatory fee FINRA charges that is based on trading activity²⁹ and generally applies to all sales of a covered security, including both sales for the member's own account and sales on behalf of a customer, regardless of where the trade is executed.³⁰ The revenue from these fees is designed to recover the costs to FINRA of the supervision and regulation of members, including performing examinations, financial monitoring, and FINRA's policymaking, rulemaking, interpretive and enforcement activities.

Section 1(b) of Schedule A to the FINRA By-Laws includes several exemptions from the TAF, including exemptions for:

- ▶ Transactions in securities offered pursuant to an effective registration statement under the Securities Act of 1933 (Securities Act) (except transactions in put or call options issued by the Options Clearing Corporation) or offered in accordance with an exemption from registration afforded by Section 3(a) or 3(b) thereof, or a rule thereunder;
- ▶ Transactions by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act (except any "Reportable TRACE Transaction"); and
- ▶ The purchase or sale of securities pursuant to and in consummation of a tender or exchange offer.

If no exemption applies, then a TAF is assessed on the transaction (*e.g.*, a TAF may be assessed on both equity and TRACE-reportable debt transactions effected in the secondary market).

Although the TAF is calculated on a per share basis, there are transaction-based caps on fees for certain transactions, including a maximum charge of \$5.95 per trade for transactions in covered equity securities. If the execution price for a covered security is less than the TAF rate on a per share, per contract, or round turn transaction basis, then no TAF is assessed on that transaction.

Request for Comment

FINRA requests comment on its rules and practices that affect the capital-raising process, including any that are not discussed in this *Notice*. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

In particular, we request comment on the following questions:

1. Have FINRA's rules covering the capital-raising process effectively responded to the problem(s) they were intended to address?
2. What have been the economic impacts, including costs and benefits, arising from FINRA's rules on the capital-raising process? To what extent would these economic impacts differ by business attributes, such as size of the firm or differences in business models?
3. Where have FINRA rules around the capital-raising process been designed particularly effectively? Are there other rules or applications where this approach might enhance capital formation while maintaining investor protections?
4. What, if any, unintended consequences have arisen from FINRA's rules related to the capital-raising process? How have firms limited or amended their business models and practices in ways unintended by FINRA with a consequence to capital formation or investor protection in order to comply with FINRA's rules in these areas?
5. Are there other FINRA rules not identified above that impact the capital-raising process? If so, what has been your experience with these rules?
6. Are there any ambiguities in the rules that FINRA should address to aid firms' compliance and enhance the capital-raising process while ensuring investor protection concerns are addressed?
7. Can FINRA make any of its administrative processes or interpretations related to the capital-raising process more efficient and effective? If so, which ones and how?
8. As currently designed, are the eligibility requirements for the CAB rules over- or under-inclusive in any respect? What changes, if any, to these requirements should be considered? Are the requirements applicable to CABs appropriately tailored to their business activities? Should any changes to these requirements be considered?
9. As currently designed, do FINRA's funding portal rules appropriately address the requirements and objectives of the JOBS Act and the SEC's Regulation Crowdfunding? What changes, if any, should be made to FINRA's rules, and why?

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. In 2014, for example, registered offerings accounted for \$1.35 trillion of new capital and an estimated \$2.1 trillion was raised through all private offering channels. Scott Bauguess, et al., *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014* (October 2015), available at <https://www.sec.gov/files/unregistered-offering10-2015.pdf>.
4. As noted by the Congressional Research Service, for example, “Congressional interest in the [Small Business Administration’s (SBA)] access to capital programs has increased in recent years, primarily because assisting small business in accessing capital is viewed as a means to enhance job creation and economic growth.” Robert Jay Dilger, U.S. Cong. Research Serv., R40985, *Small Business: Access to Capital and Job Creation*, at 1 (Aug. 26, 2016) (citations omitted), available at <https://fas.org/sqp/crs/misc/R40985.pdf>. Moreover, SBA data show that small businesses accounted for approximately 60 percent of net new jobs from 2009 to mid-2013. See SBA Office of Advocacy, *Frequently Asked Questions about Small Business*, at *1 (June 2016), available at https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf. Small businesses also have been credited with helping America recover from the recession following the 2008 financial crisis. See *SBA, Cabinet Exit Memo, SBA: Smart, Bold, Accessible*, at *2 (January 5, 2017), available at <https://obamawhitehouse.archives.gov/sites/whitehouse.gov/files/documents/SBA%20Exit%20Memo.pdf>.
5. Pub. L. 112-106, 126 Stat. 306 (2012).
6. The SEC adopted Regulation Crowdfunding on October 30, 2015. See SEA Release No. 76324 (October 30, 2015), 80 FR 71388 (November 16, 2015) (Final Rule: Crowdfunding).
7. See SEA Release No. 70957 (November 27, 2013), 78 FR 72946 (December 4, 2013) (Order Approving SR-FINRA-2013-037). See also *Regulatory Notice 13-43* (December 2013).
8. See SEA Release No. 62539 (July 21, 2010), 75 FR 44033 (July 27, 2010) (Order Approving Proposed Rule Change; File No. SR-FINRA-2010-029). See also *Regulatory Notice 10-47* (October 2010).
9. See *Regulatory Notice 17-15* (April 2017) for details of the proposed amendments to Rule 5110.
10. While some FINRA rules also may impact FINRA members that are small businesses, FINRA is separately considering what rule amendments or other steps FINRA can take to ease regulatory burdens and facilitate the growth of its smaller members.
11. The SEC approved the CAB rule set in August 2016. See SEA Release No. 78617 (August 18, 2016), 81 FR 57948 (August 24, 2016) (Order Approving Rule Change as Modified by Amendment Nos. 1 and 2 to Adopt FINRA Capital Acquisition Broker Rules; File No. SR-FINRA-2015-054). The CAB rules become

- effective on April 14, 2017. In order to provide new CAB applicants with lead time to apply for FINRA membership and obtain the necessary qualifications and registrations, CAB Rules 101-125 became effective on January 3, 2017. FINRA began accepting applications for entities that are not currently registered as broker-dealers but wish to so register and be subject to FINRA's CAB rules, for existing members requesting to elect CAB status, and for CAB associated person registration and qualification, on January 3, 2017. *See Regulatory Notice 16-37* (October 2016).
12. Crowdfunding generally refers to the use of the internet by small businesses to raise capital through limited investments from a large number of investors.
 13. FINRA is the only national securities association registered under SEA Section 15A.
 14. Some members have raised concern regarding whether certain of FINRA's Letters of Acceptance, Waiver and Consent (AWCs) with other firms impose new requirements for compliance with the research rules. AWCs are based on existing law as applied to the specific facts and circumstances at issue and are not intended to create new policies or requirements on members. As with compliance with any FINRA rule, a member should consider its unique facts and circumstances and tailor its supervisory system specifically to its business.
 15. *See Regulatory Notice 17-16* (April 2017) for details of the proposed amendments to Rule 2241 and Rule 2242.
 16. Rule 2241's predecessor—NASD Rule 2711 (Research Analysts and Research Reports)—was approved by the SEC in 2002. Rule 2711 and the NYSE's rules governing research reports were intended to restore public confidence in the validity of research and the veracity of research analysts. The trustworthiness of research had eroded due to the influences of investment banking and other conflicts that had manifest themselves during the market boom of the late 1990s. *See* Joint Report by NASD and the NYSE on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules (December 2005), available at <http://www.finra.org/web/groups/industry/@ip/@issues/@rar/documents/industry/p015803.pdf>.
 17. *See* 15 U.S.C. 78o-6. For example, Sarbanes-Oxley mandates specific rules to prohibit or restrict conduct related to the preparation, approval and distribution of research reports and the determination of research analyst compensation. Sarbanes-Oxley also mandates specific rules to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities.
 18. In 2003, federal and state authorities and self-regulatory organizations reached a settlement with 10 of the nation's largest broker-dealers to resolve allegations of misconduct involving conflicts of interest between their research analysts and investment bankers. *See* SEC Litigation Release No. 18438 (October 31, 2003). In 2004, two additional firms settled substantively under the same terms, which included provisions to effectively separate research from investment banking. *See* SEC Litigation Release Nos. 18854 and 18855 (August 26, 2004).

19. For example, Rule 2241 eliminated the exception in NASD Rule 2711 permitting pre-publication review of research by investment banking to verify the factual accuracy of information in a research report. Factual review by investment banking personnel is not permitted under the terms of the Global Settlement. However, some provisions of the Global Settlement continue to apply only to members subject to the settlement (e.g., the Global Settlement requirements with respect to chaperoning communications between research and investment banking personnel are not incorporated into FINRA rules and apply only to Global Settlement firms).
20. Consistent with the JOBS Act amendments to the SEA related to emerging growth companies (EGC), Rule 2241's quiet period-related requirements do not apply following the IPO or secondary offering of an EGC. Section 3(a) (80) of the SEA defines an EGC as "an issuer that had total annual gross revenues of less than \$1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) during its most recently completed fiscal year."

Moreover, pursuant to the SEA amendments implementing the JOBS Act, Rule 2241's prohibition on participation in pitch meetings does not apply to a research analyst that attends a pitch meeting in connection with an IPO of an EGC that is also attended by investment banking personnel. However, research analysts still are prohibited from soliciting an investment banking services transaction or promising favorable research during permissible attendance at those pitch meetings. See SEC, JOBS Act, Frequently Asked Questions About Research Analysts and Underwriters, available at <http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm>. See also FINRA, Research Rules Frequently Asked Questions, available at <http://www.finra.org/industry/faq-research-rules-frequently-asked-questions-faq>.
21. Rule 2310's predecessor—NASD Rule 2810—was adopted in 1980 to address issues arising from members' participation in oil and gas programs and real estate syndications in the 1970s. See SEA Release No. 16967 (July 8, 1980), 45 FR 47294 (July 14, 1980). The rule has been amended periodically to include additional programs and procedures to address new developments regarding members' participation in Investment Programs. For example, some significant amendments to Rule 2810 include the following: in 1982, amendments to include suitability, due diligence and disclosure requirements; see SEA Release No. 19054 (September 16, 1982), 47 FR 42226 (September 24, 1982); in 1984, to require that sales incentives be in cash; see SEA Release No. 20844 (April 11, 1984), 49 FR 15041 (April 16, 1984); in 1986, to exempt certain secondary offerings; see SEA Release No. 23619 (September 15, 1986), 51 FR 33968 (September 24, 1986); in 1994, to apply to limited partnership rollup transactions; see SEA Release No. 34533 (August 15, 1994), 59 FR 43147 (August 22, 1994); and in 2003, to modify the non-cash compensation provisions; see SEA Release No. 47697 (April 18, 2003), 68 FR 20191 (April 24, 2003).
22. The SEC recently approved FINRA's proposed amendments to Rule 2340 and Rule 2310 that require general securities members to provide more accurate per share estimated values on customer account statements, shorten the time period before a valuation is determined based on an appraisal and provide various important disclosures. See SEA Release No. 73339 (October

- 10, 2014), 79 FR 62489 (October 17, 2014) (Order Approving SR-FINRA-2014-006, as Modified by Amendment No. 1). *See also* FINRA *Regulatory Notice 15-02* (January 2015).
23. Filings under Rules 5122 and 5123 are notice filings. Accordingly, FINRA will not respond to a filing or issue a no objections letter. All filings under Rules 5122 and 5123 are afforded confidential treatment.
 24. “New issue” means any IPO of an equity security as defined in Section 3(a)(11) of the SEA made pursuant to a registration statement or offering circular, subject to some exceptions. *See* FINRA Rules 5130(i)(9) and 5131(e)(7).
 25. Specifically, Rule 5131(a) (Quid Pro Quo Allocations) prohibits a member from using an allocation of a new issue as a means of obtaining a “kick back” from the recipient in the form of excessive compensation for other services offered by the member. Rule 5131(b) (Spinning) prohibits allocations of new issues to executive officers and directors of current, and certain former or prospective, investment banking clients.
 26. Rule 5141.04 defines “fixed price offering” to mean the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act, except that the term does not include offerings of “exempted securities” or “municipal securities” as those terms are defined in SEA Sections 3(a)(12) and 3(a)(29), respectively, or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act which are offered at prices determined by the net asset value of the securities.
 27. FINRA Rule 1060(b)(15) defines “selling group” to mean any group formed in connection with a public offering, to distribute all or part of an issue of securities by sales made directly to the public by or through members of such selling group, under an agreement which imposes no financial commitment on the members of such group to purchase any such securities except as they may elect to do so. FINRA Rule 1060(b)(16) defines “selling syndicate” to mean any syndicate formed in connection with a public offering, to distribute all or part of an issue of securities by sales made directly to the public by or through participants in such syndicate under an agreement which imposes a financial commitment upon participants in such syndicate to purchase any such securities.
 28. The Rule 5250 prohibition on receiving payments for market making includes within its scope the receipt of payments for submitting a Form 211 to FINRA pursuant to Rule 6432, which sets forth the standards applicable to members for demonstrating compliance with SEA Rule 15c2-11.
 29. *See* FINRA By-Laws, Schedule A, Section 1(a). FINRA has three “Member Regulatory Fees” set forth in Section 1 of Schedule A to the FINRA By-Laws: the TAF, the Gross Income Assessment, and the Personnel Assessment.
 30. “Covered securities” for purposes of the TAF include exchange-registered securities, over-the-counter equity securities, security futures, TRACE-Eligible Securities (as defined in FINRA Rule 6710) other than U.S. Treasury Securities, and municipal securities subject to the reporting requirements of the Municipal Securities Rulemaking Board. *See* FINRA By-Laws, Schedule A, Section 1(b)(1).