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

File No.* SR - 2019 - * 022
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 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and 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 * Afshin Last Name * Atabaki

Title * Associate General Counsel

E-mail * afshin.atabaki@finra.org

Telephone * (202) 728-8902 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 07/26/2019

By Patrice M. Gliniecki

(Name *)

(Title *)

Senior Vice President and Deputy General Counsel

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.

Patrice Gliniecki,

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 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions) to exempt additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments and exempt certain types of offerings from the scope of the rules.

Specifically, the proposed rule change would: (1) incorporate the definitions of "family member" and "family client" under the Investment Advisers Act of 1940 ("Advisers Act")[2] and the rules promulgated thereunder[3] into the definition of "family investment vehicle" under FINRA Rule 5130(i)(4); (2) exclude sovereign entities that own broker-dealers from the categories of restricted persons under FINRA Rule 5130(i)(10)(E); (3) exempt foreign employee retirement benefits plans that meet specified conditions from FINRA Rules 5130 and 5131(b) (Spinning); (4) provide alternative conditions for satisfying the foreign investment company exemption under FINRA Rule 5130(c)(6); (5) exclude offerings that are conducted pursuant to Regulation S under the Securities Act of 1933 ("Securities Act")[4] and other offerings outside of the United States

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

2 15 U.S.C. 80b-2(a)(11)(G).

3 17 CFR 275.202(a)(11)(G)-1.

4 17 CFR 230.901, et seq.

and its territories from the definition of "new issue" in FINRA Rules 5130 and 5131; (6) align FINRA Rule 5130(d) (Issuer-Directed Securities) with a similar provision in FINRA Rule 5131.01 (Issuer Directed Allocations); (7) exclude unaffiliated charitable organizations from the definition of "covered non-public company" in FINRA Rule 5131(e)(3); and (8) add an anti-dilution provision for purposes of FINRA Rule 5131(b), similar to the provision in FINRA Rule 5130(e) (Anti-Dilution Provisions).

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

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.

If the Commission approves 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 30 days following publication of the Regulatory Notice announcing Commission approval.

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

(a) Purpose

FINRA Rule 5130 protects the integrity of the public offering 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 issues[5] for their own benefit at the expense of public customers. Paragraph (a) of Rule 5130 provides that, except as otherwise permitted under the rule: (1) a member (or an associated person) may not sell a new issue to an account in which a restricted person[6] has a beneficial interest;[7] (2) a member (or an associated person) may not purchase a new issue in any account in which such member or associated person has a beneficial interest; and (3) a member may not continue to hold new issues acquired as an underwriter, selling group member, or otherwise.

FINRA Rule 5131 addresses abuses in the allocation and distribution of new issues. Among other things, the rule prohibits the practice of "spinning," which is the allocation of new issues by a firm to executive officers and directors of the firm's current, former or prospective investment banking clients.

In April 2017, FINRA published Regulatory Notice 17-14 (Capital Formation) seeking comment on the effectiveness and efficiency of its rules, operations and

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5 "New issue" means any initial public offering ("IPO") of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular, subject to some exceptions. See FINRA Rules 5130(i)(9) and 5131(e)(7).

6 The term "restricted person" includes the following categories of persons: (1) broker-dealers; (2) broker-dealer personnel; (3) finders and fiduciaries; (4) portfolio managers; and (5) persons owning a broker-dealer. See FINRA Rule 5130(i)(10).

7 "Beneficial interest" means any economic interest, such as the right to share in gains or losses. The receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, is not considered a beneficial interest in the account. See FINRA Rule 5130(i)(1).

administrative processes governing broker-dealer activities related to the capital-raising process and their impact on capital formation.[8] In response to the Notice, two commenters requested that FINRA consider amending Rules 5130 and 5131 to remove certain impediments to capital formation that are unnecessary to protect investors.[9] In addition, based on FINRA's experience with the rules since their adoption, FINRA believes that amendments to Rules 5130 and 5131 are appropriate to address the impact of the rules on family offices, sovereign entities, foreign employee retirement benefits plans, foreign investment companies and executive officers and directors of charitable organizations. FINRA is proposing to amend Rules 5130 and 5131 in response to the comments it received based on Regulatory Notice 17-14 as well as FINRA's experience with the rules.

Family Offices

The definition of "restricted person" in FINRA Rule 5130 includes portfolio managers, who are persons with the authority to buy or sell securities for, among other entities, a collective investment account.[10] The term "collective investment account"[11]

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8 The comment period closed on May 30, 2017. FINRA received 11 comment letters in response to the Notice. The Notice and the comment letters are available at http://www.finra.org/industry/notices/17-14.

9 Sean Davy, Managing Director, Capital Markets Division, Securities Industry and Financial Markets Association ("SIFMA") and Sullivan & Cromwell LLP ("Sullivan & Cromwell").

10 See FINRA Rule 5130(i)(10)(D) (Portfolio Managers). The definition of "portfolio manager" also includes any immediate family member of a portfolio manager who materially supports, or receives material support from, the portfolio manager. The term "material support" is defined as directly or indirectly providing more than 25 percent of a person's income in the prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with material support. See FINRA Rule 5130(i)(8).

currently excludes a "family investment vehicle," which, in turn, is defined as a legal entity that is beneficially owned solely by immediate family members.[12] Accordingly, under the rule, a person with the authority to buy or sell securities for an account that is beneficially owned only by "immediate family members," as defined, is not considered a portfolio manager based solely on that investment authority and, therefore, is not a restricted person. FINRA excluded such persons from the definition of "portfolio manager" because family investment vehicles are often established for tax and estate planning purposes and do not manage money for unrelated persons.[13]

FINRA is proposing to expand the definition of "family investment vehicle" under Rule 5130 to include entities that are beneficially owned solely by "family members" and "family clients," which are terms used in the family office context and are defined in Advisers Act Rule 202(a)(11)(G)-1.[14] FINRA believes that an expansion that will further regulatory consistency without undermining investor protection is appropriate. As a result, the proposed rule change will incorporate these definitions into the definition of "family investment vehicle" under Rule 5130, subject to some limitations.

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11 See FINRA Rule 5130(i)(2).

12 See FINRA Rule 5130(i)(4). The term "immediate family member" is defined as a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support. See FINRA Rule 5130(i)(5).

13 See Securities Exchange Act Release No. 42325 (January 10, 2000), 5 FR 2656, 2660 (January 18, 2000) (Notice of Filing File No. SR-NASD-99-60) ("Notice of New Issue Rule Filing").

14 See 17 CFR 275.202(a)(11)(G)-1.

Family offices are entities established by families to manage their wealth and provide other services to family members and are excluded from the definition of "investment adviser" and, thus, are not subject to regulation under the Advisers Act.[15] The Advisers Act defines a "family office" as a company that, among other conditions, is wholly owned by family clients.[16] The term "family client"[17] includes, among other defined persons, "family members"[18] as well as "key employees"[19] of the family office.

Although they overlap in significant respects, differences exist between a family investment vehicle under FINRA Rule 5130 and the family office concept under the

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15 See 15 U.S.C. 80b-2(a)(11)(G); Family Offices, Advisers Act Release No. 3220 (June 22, 2011), 76 FR 37983 (June 29, 2011).

16 17 CFR 275.202(a)(11)(G)-1(b)(2).

17 17 CFR 275.202(a)(11)(G)-1(d)(4).

18 The term "family member" is defined as all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members. See 17 CFR 275.202(a)(11)(G)-1(d)(6).

19 The term "key employee" is defined as any natural person (including any key employee's spouse or spouse equivalent who holds a joint, community property, or other similar shared ownership interest with that key employee) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or its affiliated family office or any employee of the family office or its affiliated family office (other than an employee performing solely clerical, secretarial, or administrative functions with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office, provided that such employee has been performing such functions and duties for or on behalf of the family office or affiliated family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months. See 17 CFR 275.202(a)(11)(G)-1(d)(8).

Advisers Act. These differences create inconsistencies, which do not further the purposes of FINRA Rule 5130, with respect to the treatment of family offices under the two regimes. For example, the definition of "immediate family member" under FINRA Rule 5130 includes a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law and children, whereas the definition of "family member" under the Advisers Act includes lineal descendants of a common ancestor and the lineal descendants' spouses or spousal equivalents.[20] As a result, and by way of example, the inclusion of grandchildren or grandparents in a collective investment account will not disqualify the account from the family office designation under the Advisers Act on that basis, but would cause such an account to fall outside of the definition of "family investment vehicle" under FINRA Rule 5130.

Another difference is that the terms "immediate family member" and "family client" each address categories of non-family members; however, they do so in different ways. Specifically, the definition of "immediate family member" under FINRA Rule 5130 includes any individual to whom the person provides material support, which could encompass non-family members.[21] The definition of "family client" under the Advisers Act includes key employees of the family office, which may also cover non-family members but not necessarily only those non-family members who receive material support.[22] As a result of this difference, a person who has the authority to buy or sell

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20 See 17 CFR 275.202(a)(11)(G)-1(d)(6); supra note 18.

21 See supra note 12.

22 See supra note 19.

securities for an account that is beneficially owned by family clients could be considered a portfolio manager based exclusively on that investment authority, and thus a restricted person under FINRA Rule 5130.

Given the significant overlap between these concepts, and FINRA's belief that the differences do not serve the purposes of the rule, FINRA is proposing to incorporate the definitions of "family member" and "family client" under the Advisers Act into the definition of "family investment vehicle" under Rule 5130, subject to some limitations. Specifically, the proposed rule change would amend FINRA Rule 5130(i)(4) to define a "family investment vehicle" as a legal entity that is beneficially owned solely by one or more of the following persons: (1) "immediate family members" as defined under FINRA Rule 5130(i)(5); (2) "family members" as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(6); or (3) "family clients" as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(4);[23] provided, however, that where the beneficial owners of such an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity is an "immediate family member" as defined in FINRA Rule 5130(i)(5) or a "family member" as defined in Advisers Act Rule 202(a)(11)(G)-1(d)(6).

The first category would preserve the current exception in FINRA Rule 5130 and would provide relief from portfolio manager status under the rule for a person who has the authority to buy or sell securities for an account that is beneficially owned only by immediate family members. The second category would provide relief from portfolio

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23 As noted above, the term "family client" includes not only family members but others, including key employees. See 17 CFR 275.202(a)(11)(G)-1(d)(4). Therefore, a family investment vehicle that is beneficially owned solely by family clients may include beneficial owners that are not family members.

manager status under the rule for a person who has the authority to buy or sell securities for an account that is beneficially owned only by "family members," as defined in the Advisers Act. The third category would provide relief from portfolio manager status under the rule for a person who has the authority to buy or sell securities for an account that is owned only by "family clients," as defined in the Advisers Act. In addition, the proposed rule change would provide relief to a legal entity that is beneficially owned by any combination of these categories.

However, the proposed rule change contains an important caveat where the beneficial owners are not solely immediate family members or family members under FINRA Rule 5130(i)(5) or Advisers Act Rule 202(a)(11)(G)-1(d)(6), respectively. Specifically, in such cases, the proposed rule change would only provide relief from portfolio manager status if the person who has the authority to buy or sell securities for the account is an "immediate family member," as defined in FINRA Rule 5130, or a "family member," as defined in the Advisers Act.[24] FINRA believes that it is necessary to impose this condition to safeguard against the abuses the rule is designed to address and to ensure that, for purposes of Rule 5130, the person who has the authority to buy or sell securities for the account is more closely aligned with the family than with key employees or others associated with the family office. FINRA believes that the proposed rule change strikes the proper balance between the treatment of family investment

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24 Further, the proposed relief is only with respect to a person's status as a portfolio manager under FINRA Rule 5130. The proposed relief does not extend to a person who has a beneficial interest in a family investment vehicle and is a restricted person based on his or her other activities, such as an associated person of a member.

vehicles in FINRA Rule 5130 and the recognition of the family office exemption under the Advisers Act.

Sovereign Entities

The definition of "restricted person" in FINRA Rule 5130 includes, among others, direct and indirect owners of broker-dealers that are listed, or required to be listed, on Schedules A and B of Form BD (Uniform Application for Broker-Dealer Registration) and that have an ownership interest above specified thresholds.[25] The definition of "restricted person" includes owners of broker-dealers because the prohibition on purchases of new issues by a broker-dealer could be circumvented if the owners of a broker-dealer were permitted to purchase new issues.[26]

A sovereign wealth fund ("SWF") is a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation.[27] Occasionally, an SWF or sovereign nation (collectively, a "sovereign entity") may acquire a direct or an indirect ownership

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25 See FINRA Rule 5130(i)(10)(E) (Persons Owning a Broker-Dealer). FINRA Rule 5130 also provides an exception for an owner of a "limited business broker-dealer," which is defined as a broker-dealer whose authorization to engage in the securities business is limited solely to the purchase and sale of investment company/variable contracts securities and direct participation program securities. See FINRA Rules 5130(i)(7) and 5130(i)(10)(E).

26 See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126, 62133 (October 31, 2003) (Order Approving File No. SR-NASD-99-60) ("New Issue Rule Approval Order").

27 There is no standard definition of the term "sovereign wealth fund," and the term is not defined under the federal securities laws. See, e.g., Celeste Cecelia Moles Lo Turco, Sovereign Wealth Funds: From Transparency to Sustainability, Sovereign Wealth Funds Law Centre, Bi-Annual Legal Report, October 2013 (noting the absence of a commonly accepted definition of "sovereign wealth fund").

stake in a registered broker-dealer, requiring the sovereign entity to be listed on Schedule A or B of Form BD. Moreover, the sovereign entity's ownership interest could exceed the specified thresholds in FINRA Rule 5130(i)(10)(E), which would make the sovereign entity a restricted person.

Rule 5130(i)(10)(E) was not intended to encompass sovereign entities that acquire an ownership interest in a registered broker-dealer. Instead, as discussed above, the inclusion of owners of broker-dealers in the categories of restricted persons was intended to prevent circumvention of the prohibition on purchases of new issues by broker-dealers. FINRA believes that sovereign entities are unlikely to circumvent the rule's prohibition by reallocating new issue shares to broker-dealers and are inherently not designed for such a purpose. Further, FINRA notes that significant investments by sovereign entities currently are subject to distinct legal and regulatory requirements.[28]

To address the unintended application of FINRA Rule 5130 to sovereign entities, the proposed rule change would exclude sovereign entities from the scope of owners of broker-dealers under Rule 5130(i)(10)(E). The proposed exclusion would not apply to affiliates of sovereign entities that are otherwise restricted. Accordingly, while a sovereign entity that owns a broker-dealer would not be considered a restricted person under the proposed rule change, the broker-dealer would continue to be a restricted person under FINRA Rule 5130.

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[28] For example, specific investments by sovereign entities in the United States that raise national security concerns are subject to review by the Committee on Foreign Investment in the United States (CFIUS). CFIUS is an interagency committee of the federal government chaired by the Department of the Treasury and authorized to review transactions that could result in control of a U.S. business by a foreign person to determine the effect of such transactions on the national security of the United States. See 31 CFR 800.

The proposed rule change would also amend FINRA Rule 5130(i) (Definitions) to define the term "sovereign entity" for purposes of the rule as "a sovereign nation or a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation." The proposed rule change would further define the term "sovereign nation" as "a sovereign nation or its political subdivisions, agencies or instrumentalities."

Foreign Employee Retirement Benefits Plans

FINRA Rule 5130(c)(7) provides a general exemption from the rule's prohibitions for an Employee Retirement Income Security Act ("ERISA") benefits plan that is qualified under Section 401(a) of the Internal Revenue Code ("IRC"), provided that the plan is not sponsored solely by a broker-dealer. Employee retirement benefits plans that are organized under and governed by foreign laws, even when similar to qualifying ERISA plans in all material respect, are not subject to ERISA and do not qualify for the exemption in FINRA Rule 5130(c)(7).[29] Because foreign employee retirement benefits plans may invest in assets on behalf of potentially hundreds of thousands of participants and beneficiaries, such plans may be unable to determine whether persons with a beneficial interest are restricted persons under FINRA Rule 5130. As a result, such plans may find it impossible to assess whether they may permissibly invest in new issues. Currently, FINRA Rule 5130 does not include a general exemption for foreign employee

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29 ERISA explicitly excludes from coverage employee benefit plans that are "maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens." 29 U.S.C. 1003(b)(4).

retirement benefits plans, although FINRA has previously acknowledged that such an exemption may be appropriate.[30]

In recent years, FINRA staff has granted several requests for exemption from the rule for foreign employee retirement benefits plans.[31] In each case, the foreign employee retirement benefits plans were organized under and governed by foreign laws, had an extensive number of participants and beneficiaries and significant assets in the employer's retirement fund or family of retirement funds, and were administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries. Under these circumstances, the plans stated that the funds plainly could not serve as a conduit for restricted persons to purchase new issues. FINRA staff agreed that the concerns underlying the rule were not served in light of those circumstances and, as such, FINRA staff granted exemptions from FINRA Rule 5130 in connection with the foreign employee retirement benefits plans.

FINRA is proposing to codify this position by amending FINRA Rule 5130(c) (General Exemptions) to provide an exemption for an employee retirement benefits plan

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30 See Restrictions on the Purchase and Sale of Initial Equity Public Offerings Amendment No. 3, File No. SR-NASD-99-60 (March 19, 2001), http://www.finra.org/sites/default/files/RuleFiling/p000150.pdf.

31 See Letter from Gary L. Goldsholle, FINRA, to Edward A. Kwalwasser, Proskauer Rose LLP, dated December 7, 2010, http://www.finra.org/industry/exemptive-letters/december-7-2010-1200am; Letter from Afshin Atabaki, FINRA, to Christopher M. Wells, Proskauer Rose LLP, dated November 2, 2012, http://www.finra.org/industry/exemptive-letters/november-2-2012-1200am; Letter from Meredith Cordisco, FINRA, to Amy Natterson Kroll, Morgan, Lewis & Bockius LLP, dated July 23, 2015, http://www.finra.org/industry/exemptive-letters/july-23-2015-1200am; and Letter from Meredith Cordisco, FINRA, to Amy Natterson Kroll, Morgan, Lewis & Bockius LLP, dated April 16, 2018, http://www.finra.org/industry/exemptive-letters/april-16-2018-1200am.

organized under and governed by the laws of a foreign jurisdiction, provided that such a plan or family of plans: (1) has, in aggregate, at least 10,000 participants and beneficiaries and $10 billion in assets; (2) is operated in a non-discriminatory manner insofar as a wide range of employees, regardless of income or position, are eligible to participate without further amendment or action by the plan sponsor;[32] (3) is administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries; and (4) is not sponsored by a broker-dealer. Under these conditions, FINRA believes that the plan(s) are not likely to serve as a conduit for circumventing the rule. In addition, FINRA believes that the rationale for exempting ERISA benefits plans applies equally to foreign benefits plans when these conditions are met, and such plans should be afforded similar treatment under the rule.

Finally, FINRA Rule 5131(b)(2) sets forth the exemptions applicable to the spinning provision. The exemptions generally correspond to those under FINRA Rule 5130(c). Therefore, in conjunction with adding foreign employee retirement benefits plans to Rule 5130(c), FINRA is also proposing to amend Rule 5131(b)(2) to add a corresponding exemption to that rule. This proposed change will minimize unnecessary regulatory burdens without undermining the rule's stated objective, as the practice of spinning is unlikely to occur in connection with a covered person's beneficial interest in a foreign employee retirement benefits plan.

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32 The definition of "broad-based foreign retirement plan" under Section 409A of the IRC includes a substantially similar condition. See 26 CFR 1.409A-1(a)(3)(v)(A). Section 409A imposes restrictions on the deferral of compensation by employees, directors and independent contractors. Section 409A provides an exemption for compensation deferred under certain broad-based foreign retirement plans.

Alternative Conditions for Foreign Investment Company Exemption

Paragraph (c)(6) of FINRA Rule 5130 currently exempts sales to and purchases by an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; and (2) no person owning more than five percent of the shares of the investment company is a restricted person. The foreign investment company exemption is intended to apply to foreign investment companies that are similar to U.S. registered investment companies, which are currently exempt from FINRA Rule 5130's prohibitions.[33]

The purpose of the five percent condition is to prevent purchases of new issues by foreign investment companies with concentrated ownership interests of restricted persons.[34] However, based on FINRA's experience with the rule, including informal discussions with industry groups and market participants in the years since the rule's adoption, FINRA understands that it is operationally impractical for a foreign investment company to determine whether an investor owns more than five percent of its shares where the investor acquires his or her interest through an intermediary that then holds the shares for multiple investors in an omnibus or nominee account as distinguished from an account that holds shares of a single investor. Further, an investor may acquire shares of a foreign investment company through multiple intermediaries or through multiple omnibus or nominee accounts at the same intermediary. In such cases, foreign investment companies are not able to satisfy the five percent condition.

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33 See FINRA Rule 5130(c)(1).

34 See New Issue Approval Order, 68 FR at 62138.

When FINRA (then NASD) originally proposed the foreign investment company exemption as part of NASD Rule 2790 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), the exemption included an additional condition that required the foreign investment company to have 100 or more investors.[35] During the rulemaking process, however, FINRA determined to simplify the exemption by eliminating the 100 investor requirement because the condition addressed the same concerns about concentration of ownership as the five percent condition.[36]

Given the operational issues raised by the five percent condition, FINRA is proposing to amend Rule 5130(c)(6) to provide the following two alternative methods to establish that a foreign investment company is widely held for purposes of the rule: (1) the investment company has 100 or more direct investors; or (2) the investment company has 1,000 or more indirect investors.[37] FINRA believes that satisfying either of these two conditions would also assuage concerns about concentration of ownership. The proposed rule change would also add a condition to paragraph (c)(6) to ensure that the foreign investment company is not formed for the specific purpose of investing in new issues.

Therefore, as proposed, paragraph (c)(6) of FINRA Rule 5130 would exempt sales to and purchases by an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for

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35 See Notice of New Issue Rule Filing, 5 FR at 2657.

36 See New Issue Approval Order, 68 FR at 62137.

37 As noted above, in some jurisdictions, investors may invest through layers of intermediaries, with the legal ownership held by nominees. FINRA believes that a foreign investment company would be considered to be widely held on an indirect basis if it has 1,000 or more indirect investors.

sale to the public or authorized for sale to the public by a foreign regulatory authority; (2) no person owning more than five percent of the shares of the investment company is a restricted person, the investment company has 100 or more direct investors, or the investment company has 1,000 or more indirect investors; and (3) the investment company was not formed for the specific purpose of investing in new issues.[38]

Exclusion for Foreign Offerings

As noted above, for purposes of FINRA Rules 5130 and 5131, the term "new issue" means any IPO of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular, subject to some exceptions.[39] Currently, the definition is not expressly limited to domestic securities offerings. Accordingly, the rules could apply to foreign offerings, even if a safe harbor is available for those offerings under the Securities Act, to the extent that a member or an associated person is participating in the offering or receiving allocations of new issues as an investor.[40]

In connection with Regulatory Notice 17-14, SIFMA and Sullivan & Cromwell requested that FINRA expressly exclude from Rules 5130 and 5131 offerings that are

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38 The proposed rule change also impacts an identical exemption cross referenced in paragraph (b)(2) of FINRA Rule 5131. The proposed rule change would not undermine the objectives of the spinning provision, as spinning would be unlikely to occur in connection with a foreign investment company when the proposed conditions are met.

39 See Rules 5130(i)(9) and 5131(e)(7). The definition of "new issue" does not include, among others, offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act, or Securities Act Rule 504 if the securities are "restricted securities" under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder. See Rule 5130(i)(9)(A).

40 See Notice to Members 03-79 (December 2003) at n.13.

conducted pursuant to Regulation S, which provides a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities. SIFMA suggested that FINRA's goals of investor protection and fostering fair public capital markets are not present when members are participating in transactions conducted wholly offshore, and Sullivan & Cromwell stated that such a carve-out would provide clarity to the industry.[41] Some foreign jurisdictions may not restrict market participants, such as broker-dealers, from purchasing IPO shares for their own account. By prohibiting members and associated persons from purchasing IPO shares in foreign offerings, the current rule may indirectly impede the capital formation process in those foreign jurisdictions. Further, Regulation S offerings are currently excluded from the definition of "public offering" for purposes of FINRA Rules 5110 (Corporate Financing Rule — Underwriting Terms and Arrangements) and 5121 (Public Offerings of Securities With Conflicts of Interest). FINRA believes that an exclusion from Rules 5130 and 5131 for Regulation S offerings is also appropriate. In addition, FINRA believes that the exclusion should be extended to other offerings made outside of the United States or its territories and not just those that are expressly designated as Regulation S offerings.

Issuer-Directed Securities

FINRA Rules 5130(d) and 5131.01 each contain exemptive provisions for new issue allocations that are directed by an issuer, when specified conditions are met, because the regulatory concerns that the rules are designed to address are not present with

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41 See SIFMA at 8; Sullivan & Cromwell at 7-8.

respect to allocations of securities that are not controlled by an underwriter. However, these exemptions are not identical, in that FINRA Rule 5131 exempts allocations directed by affiliates and selling shareholders, while FINRA Rule 5130 does not.

In response to Regulatory Notice 17-14, SIFMA requested better alignment of these provisions.[42] FINRA agrees that a conforming change to FINRA Rule 5130(d) to more closely align the rule with the issuer-directed provision in FINRA Rule 5131.01 will provide regulatory consistency without negatively impacting investor protection or the integrity of the market for new issues and would not impact the spinning provision of Rule 5131. Specifically, the proposed rule change would amend paragraphs (d)(1) and (d)(2) of Rule 5130 to expand the exemption for issuer-directed securities to allocations directed by affiliates and selling shareholders of the issuer. The change will also clarify that the exemption applies to shares that are specifically directed in writing by the issuer.

Exclusion for Unaffiliated Charitable Organizations

As noted above, paragraph (b) of FINRA Rule 5131 prohibits the practice of "spinning," which is the allocation of new issues to executive officers and directors of current and certain former or prospective investment banking clients. 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

42 See SIFMA at 7, n.10.

company[43] or a covered non-public company,[44] or a person materially supported[45] by such executive officer or director, has a beneficial interest:[46] (1) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months; (2) if the 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 (3) on the express or implied condition that such executive officer or director, on behalf of the company, will retain the member for the performance of future investment banking services.

Because executive officers and directors are often in a position to hire 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 executive

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43 FINRA Rule 5131(e)(1) defines "public company" as "any company that is registered under Section 12 of the Exchange Act or files periodic reports pursuant to Section 15(d) thereof." See FINRA Rule 5131(e)(1).

44 The term "covered non-public company" means any non-public company satisfying the following criteria: (1) 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; (2) shareholders' equity of at least $30 million and a two-year operating history; or (3) 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 FINRA Rule 5131(e)(3).

45 Similar to the definition in FINRA Rule 5130(i)(8), FINRA Rule 5131 defines "material support" to mean directly or indirectly providing more than 25 percent 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 FINRA Rule 5131(e)(6).

46 The term "beneficial interest" has the same meaning as in FINRA Rule 5130. See FINRA Rule 5131(e)(2).

officers and directors from the company on whose behalf they must act. Industry groups and market participants have noted that these same concerns are not implicated in the case of executive officers and directors of charitable organizations. However, due to their asset size, some charitable organizations fall within the definition of a covered non-public company, making executives or directors of such organizations the subject of the rule's prohibition. FINRA believes that charitable organizations are not likely to generate significant investment banking business and, thus, there is a low risk, if any, that improper incentives would motivate a member's or an associated person's decision to allocate shares to the account of executive officers or directors of such organizations.

FINRA is proposing to amend paragraph (e)(3) of Rule 5131 (Definitions) to exclude unaffiliated charitable organizations, as that term is elsewhere defined in the rule,[47] from the definition of "covered non-public company." As a result of this proposed amendment, an executive officer or director of a charitable organization that is not affiliated with the member allocating IPO shares would not become the subject of the rule's spinning provision solely on the basis of that service.

Addition of Anti-Dilution Provision to FINRA Rule 5131

FINRA Rule 5130 allows restricted persons that are existing equity owners of an issuer to purchase shares of the issuer in a public offering in order to maintain their equity ownership position. However, FINRA Rule 5131 currently does not include a similar

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

anti-dilution provision for executive officers and directors who are subject to the prohibition on spinning set forth in Rule 5131(b). In response to Regulatory Notice 17-14, SIFMA urged FINRA to create symmetry between the rules by adding an anti-dilution provision for purposes of Rule 5131(b).[48] FINRA agrees that executive officers and directors of public companies and covered non-public companies who are subject to Rule 5131's spinning provision should be able to maintain the same equity ownership level that they held prior to the offering. Accordingly, the proposed rule change would amend Rule 5131 to add an anti-dilution provision to the rule similar to the one in Rule 5130(e), and would thus allow an executive officer or director of a public company or a covered non-public company (or a person materially supported by such a person) to retain the percentage equity ownership in the issuer at a level up to the ownership interest as of three months prior to the filing of the registration statement, provided that the other conditions are met.

As noted in Item 2 of this filing, if the Commission approves 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 30 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

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48 See SIFMA at 7, n.10. In addition, SIFMA requested that FINRA consider amending Rule 5131(d)(3) (Agreement Among Underwriters) relating to the treatment of returned shares to allow members the option of selling such shares in the secondary market and donating profits anonymously to an unaffiliated charity when a syndicate short position exists, consistent with a similar option when no syndicate short position exists. See SIFMA 8-9. FINRA considered this comment and has determined not to proceed with any changes to Rule 5131(d)(3).

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[49] 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 rule change will further these purposes by promoting capital formation and aiding member compliance efforts, while maintaining the integrity of the public offering process and investor confidence in the capital markets.

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

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

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, the economic baseline of analysis, the economic impact and the alternatives considered.

A. Regulatory Need

Based upon FINRA's experience with Rules 5130 and 5131, as well as input from industry groups and market participants regarding practical and operational issues relating to the rules, FINRA is proposing amendments to reduce the regulatory burden on firms and remove certain impediments to capital formation without impacting investor protection. The proposed rule change aims to foster capital formation and to bring regulatory clarity and consistency. Specifically, FINRA is proposing to exempt

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[49] 15 U.S.C. 78o-3(b)(6).

additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments and exempt certain types of offerings from the scope of the rules.

B. Economic Baseline

The economic baseline for the proposed rule change is the current requirements and provisions of FINRA Rules 5130 and 5131, which are intended to protect the integrity of the public offering process. To this end, Rule 5130 sets forth categories of persons that are restricted from purchasing new issues. In addition, Rule 5131 places restrictions on the allocation of new issues to executive officers and directors of a member's current, former or prospective investment banking clients.

To assess the current economic baseline, FINRA has analyzed the current groups potentially affected by the various aspects of the proposed rule change. FINRA believes that there are thousands of family offices that, along with the family members and family clients served by those offices, are potentially impacted by the proposed rule change.[50] With respect to sovereign entities, there are approximately 195 independent states in the world,[51] many of which operate one or more sovereign wealth funds, and the number is believed to be on the rise.[52] FINRA understands that there are thousands of foreign

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50 The exact number of family offices in the United States is not known; however, it is estimated that there are between 3,000 and 5,000 single family offices operating in the United States. See, e.g., Mary Pollack, Family Office Exchange, https://www.familyoffice.com/insights/how-many-family-offices-are-there-united-states.

51 See U.S. Department of State, Fact Sheet, Bureau of Intelligence and Research, Independent States in the World, https://www.state.gov/s/inr/rls/4250.htm.

52 See Sovereign Wealth Fund Institute, Sovereign Wealth Fund Rankings, http://www.swfinstitute.org/sovereign-wealth-fund-rankings/.

pension plans (including both state- and privately-operated foreign plans) as well as millions of beneficiaries and participants of those plans. Similarly, FINRA understands that there are thousands of foreign investment companies and millions of investors in such companies. As of 2013, there were over one million organizations with Section 501(c)(3) status in the United States, though the number of charitable organizations that are large enough to fall within the current definition of "covered non-public company" in Rule 5131(e)(3) is likely smaller than that figure.[53]

C. Economic Impact

For purposes of this discussion, FINRA has identified the potentially material impacts of the proposed amendments on the affected parties.

FINRA believes that the proposed amendments to Rules 5130 and 5131 will remove unnecessary impediments to capital formation and lessen burdens in the public offering process. The proposed amendments will generally have a beneficial impact on issuers, underwriters and selling group members and certain categories of investors.

FINRA believes that a significant impact of the proposed amendments will be a reduction in both the costs and uncertainty in determining whether an investor is subject to the restrictions of Rules 5130 and 5131. The proposed rule change also may increase the pool of investors eligible to purchase new issues and, thus, encourage capital formation. FINRA believes that the proposed amendments would not alter the original purpose of Rules 5130 and 5131 in ensuring the integrity of a public offering.

FINRA Rule 5130 restricts members and associated persons from purchasing new issues for their own account or selling new issues to an account in which other restricted

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[53] See National Center for Charitable Statistics, http://nccs.urban.org.

persons have a beneficial interest. Currently the definition of "restricted person" in Rule 5130(i)(10) captures certain persons that were not intended to be included in the definition. To address this issue, the proposed rule change would exempt from the definition of "restricted person": (1) a person with the authority to buy or sell securities for an account beneficially owned by a family office, subject to specified conditions; and (2) sovereign entities that acquire an ownership interest in a registered broker-dealer. These persons would benefit from the proposed rule change by eliminating their restrictions from purchasing new issues, thus increasing their set of potential investments. To the extent that new issues provide a unique risk-return profile from other types of securities investments, the inclusion of them in these persons' portfolios would be value enhancing. The proposed rule change would also better align with the Advisers Act's treatment of family offices.

FINRA Rule 5130 currently does not include a general exemption for foreign employee retirement benefits plans. Rather, FINRA staff has granted exemptive relief to certain foreign employee retirement benefits plans that have demonstrated that they cannot serve as a conduit for restricted persons to purchase new issues. The proposed rule change codifies the criteria upon which the staff granted exemptive relief. The proposed rule change would allow plans that meet specified criteria to invest in new issues without having to determine the eligibility of hundreds of thousands of participants and beneficiaries. By providing such plans additional flexibility to invest in new issues, the proposed rule change would enhance the investment options for their equity portfolios. The codification of the criteria would also improve regulatory uniformity and reduce compliance costs.

The foreign investment company exemption in FINRA Rule 5130(c)(6) is intended to apply to foreign investment companies that are similar to U.S. registered investment companies, which are currently exempt from FINRA Rule 5130's prohibitions. In order to satisfy the current exemption, the foreign investment company, among other conditions, must establish that no person owning more than five percent of the shares of the investment company is a restricted person. However, where an investor acquires his or her interest in a foreign investment company through an intermediary that then holds the shares for multiple investors in an omnibus or nominee account, the foreign investment company may not be able to determine whether the investor owns more than five percent of its shares. The proposed rule change would address this operational issue and create two alternative conditions that the foreign investment company have 100 or more direct investors or 1,000 or more indirect investors. The proposed alternative conditions would provide additional flexibility to foreign investment companies to demonstrate their eligibility for the exemption, and thereby enhance their ability to purchase new issues.

FINRA Rules 5130 and 5131 are primarily concerned with fostering fair public capital markets within the United States. However, because the definition of "new issue" is not expressly limited to domestic offerings, the rules could apply to foreign offerings, even if a safe harbor is available for those offerings under the Securities Act, if a member or an associated person is participating in the offering or receiving allocations as an investor. The proposed rule change would clarify the scope of Rules 5130 and 5131 by excluding Regulation S offerings and other offerings made outside of the United States or its territories from the scope of the rules. The proposed rule change would also harmonize Rules 5130 and 5131 with other FINRA rules relating to securities offerings, FINRA Rules 5110 and 5121, which currently exclude foreign offerings. FINRA believes that the proposed rule change will remove the burdens associated with complying with both U.S. and foreign regulatory regimes relating to public offerings and will lead to an increase in the pool of eligible investors for offshore offerings of new issues without undermining the fairness of U.S. public capital markets. Further, an increase in the pool of eligible investors could lead to a lower cost of capital for issuers engaged in foreign offerings.

The issuer-directed provisions in FINRA Rules 5130 and 5131 are similar, but have differences that do not further the purposes of the rules. The proposed rule change would better align the issuer-directed provisions of Rules 5130 and 5131, provide regulatory consistency across the rules and remove the compliance costs of applying different standards, without negatively impacting the purposes of the rules.

Charitable organizations may not generate significant investment banking business. However, due to their asset size, some charitable organizations may fall within the definition of a "covered non-public company" under FINRA Rule 5131, making executives or directors of such organizations the subject of the rule's prohibition. FINRA believes that the concerns addressed by the rule are not implicated with respect to executive officers or directors of charitable organizations that are not affiliated with a member. The proposed rule change, therefore, would exclude "unaffiliated charitable organizations," as currently defined in Rule 5131, from the definition of "covered non-public company." FINRA believes that this proposed change will ease the burden on firms as they will no longer be required to consider whether an investment banking relationship exists vis-à-vis the member and an unaffiliated charitable organization when an individual with a beneficial interest in an account is an executive officer or director (or materially supported by such a person) of such an organization. FINRA believes that the proposed rule change would provide benefits by reducing the uncertainty of whether a particular relationship is problematic and by reducing the time and costs associated with making that determination. The proposed rule change will also impact individuals who are executive officers or directors of unaffiliated charitable organizations (and those materially supported by such individuals) as they will no longer be subject to the rule's prohibitions on that basis. Finally, the proposed rule change will benefit issuers by increasing the pool of prospective investors, thus potentially leading to a lower cost of capital for the issuers.

Finally, the anti-dilution provision of FINRA Rule 5130 allows restricted persons to maintain the equity ownership interest they had before a public offering, but FINRA Rule 5131 has no similar provision. An unintentional result of this is that officers or directors of public companies and covered non-public companies may experience diminished ownership interest upon a public offering and a transfer of wealth from them to those investors that are able to purchase shares in the new offering. The proposed rule change would add an anti-dilution provision to Rule 5131 similar to that of Rule 5130 and ameliorate this inconsistency. This would reduce the regulatory uncertainty and create a level playing field for all investors.

D. Alternatives Considered

FINRA considered various alternatives to the proposed rule change. When assessing foreign pension plans, FINRA considered whether to impose a requirement that the plan, or family of plans, have a greater number of participants and beneficiaries than the proposed 10,000. However, the 10,000 participants and beneficiaries figure is appropriate, particularly when viewed along with the condition that the plan have at least $10 billion in assets, and exceeds participant thresholds contained in other parts of the rule.[54]

With respect to the foreign investment company exemption, FINRA considered allowing foreign investment companies to establish dilution of the fund solely by satisfying the current five percent condition. However, allowing the foreign investment company to satisfy either the five percent condition, the 100 or more direct investor condition, or the 1,000 or more indirect investor condition, in addition to the other conditions, achieves the purpose of the rule while providing greater flexibility for foreign investment companies to meet the conditions of the exemption.

In assessing the appropriateness of an exclusion for charitable organizations from the definition of "covered non-public company" in Rule 5131(e)(3), FINRA considered whether to extend the exclusion to all nonprofit organizations, including, for example, civic leagues or social welfare entities organized pursuant to other sections of the IRC.[55] However, FINRA determined not to extend the definition in this manner and notes that, unlike Section 501(c)(3) organizations, such organizations are not prohibited from substantially engaging in other activities. In addition, limiting the exclusion to Section

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54 See, e.g., Rule 5130(c)(3)(A) (exempting sales to and purchases of new issues by an insurance company general, separate or investment account, provided that, among other conditions, the account is funded by premiums from 1,000 or more policyholders).

55 Civic leagues and social welfare organizations may be organized pursuant to Section 501(c)(4) of the IRC.

501(c)(3) charitable organizations is consistent with the treatment of such entities in the context of other provisions of Rules 5130 and 5131.[56]

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

Written comments were neither solicited nor received on the proposed rule change. As noted above, in April 2017, FINRA published Regulatory Notice 17-14 seeking comment on the effectiveness and efficiency of its rules relating to the capital-raising process, including FINRA Rules 5130 and 5131 generally, and, in response, two commenters requested that FINRA consider certain amendments to Rules 5130 and 5131.[57]

In addition to comments received in response to Regulatory Notice 17-14, FINRA has experience with the rules since their adoption that has informed the proposed rule change. During that time, FINRA has generally engaged in discussions with industry groups and market participants regarding: (1) persons with authority to buy or sell securities on behalf of accounts beneficially owned by family offices; (2) sovereign entities that own broker-dealers; (3) foreign employee retirement benefits plans; (4) executive officers and directors of unaffiliated charitable organizations; and (5) foreign investment companies whose shares are held in omnibus or nominee accounts. The proposed rule change also reflects FINRA's experience and years of informal discussions with market participants.

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56 See, e.g., Rule 5130(c)(9) (exempting Section 501(c)(3) tax exempt charitable organizations from Rule 5130); Rule 5131(e)(9) (defining unaffiliated charitable organization as a tax-exempt entity organized under Section 501(c)(3) of the IRC).

57 See supra notes 8 and 9.

FINRA believes that the proposed rule change strikes the appropriate balance by promoting capital formation and aiding member compliance efforts while maintaining the protections that Rules 5130 and 5131 are designed to provide, as discussed above.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[58]

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.

11. Exhibits

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

Exhibit 5. Text of proposed rule change.

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58 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2019-022)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and 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 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions) to exempt additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments and exempt certain types of offerings from the scope of the rules.

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

2 17 CFR 240.19b-4.

Specifically, the proposed rule change would: (1) incorporate the definitions of "family member" and "family client" under the Investment Advisers Act of 1940 ("Advisers Act")[3] and the rules promulgated thereunder[4] into the definition of "family investment vehicle" under FINRA Rule 5130(i)(4); (2) exclude sovereign entities that own broker-dealers from the categories of restricted persons under FINRA Rule 5130(i)(10)(E); (3) exempt foreign employee retirement benefits plans that meet specified conditions from FINRA Rules 5130 and 5131(b) (Spinning); (4) provide alternative conditions for satisfying the foreign investment company exemption under FINRA Rule 5130(c)(6); (5) exclude offerings that are conducted pursuant to Regulation S under the Securities Act of 1933 ("Securities Act")[5] and other offerings outside of the United States and its territories from the definition of "new issue" in FINRA Rules 5130 and 5131; (6) align FINRA Rule 5130(d) (Issuer-Directed Securities) with a similar provision in FINRA Rule 5131.01 (Issuer Directed Allocations); (7) exclude unaffiliated charitable organizations from the definition of "covered non-public company" in FINRA Rule 5131(e)(3); and (8) add an anti-dilution provision for purposes of FINRA Rule 5131(b), similar to the provision in FINRA Rule 5130(e) (Anti-Dilution Provisions).

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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[3] 15 U.S.C. 80b-2(a)(11)(G).

[4] 17 CFR 275.202(a)(11)(G)-1.

[5] 17 CFR 230.901, et seq.

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 5130 protects the integrity of the public offering 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 issues[6] for their own benefit at the expense of public customers. Paragraph (a) of Rule 5130 provides that, except as otherwise permitted under the rule: (1) a member (or an associated person) may not sell a new issue to an account in which a restricted person[7] has a beneficial interest;[8] (2) a

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6 "New issue" means any initial public offering ("IPO") of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular, subject to some exceptions. See FINRA Rules 5130(i)(9) and 5131(e)(7).

7 The term "restricted person" includes the following categories of persons: (1) broker-dealers; (2) broker-dealer personnel; (3) finders and fiduciaries; (4) portfolio managers; and (5) persons owning a broker-dealer. See FINRA Rule 5130(i)(10).

member (or an associated person) may not purchase a new issue in any account in which such member or associated person has a beneficial interest; and (3) a member may not continue to hold new issues acquired as an underwriter, selling group member, or otherwise.

FINRA Rule 5131 addresses abuses in the allocation and distribution of new issues. Among other things, the rule prohibits the practice of "spinning," which is the allocation of new issues by a firm to executive officers and directors of the firm's current, former or prospective investment banking clients.

In April 2017, FINRA published Regulatory Notice 17-14 (Capital Formation) seeking 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.[9] In response to the Notice, two commenters requested that FINRA consider amending Rules 5130 and 5131 to remove certain impediments to capital formation that are unnecessary to protect investors.[10] In addition, based on FINRA's experience with the rules since their adoption, FINRA believes that amendments to Rules 5130 and 5131 are appropriate to address the impact

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8 "Beneficial interest" means any economic interest, such as the right to share in gains or losses. The receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, is not considered a beneficial interest in the account. See FINRA Rule 5130(i)(1).

9 The comment period closed on May 30, 2017. FINRA received 11 comment letters in response to the Notice. The Notice and the comment letters are available at http://www.finra.org/industry/notices/17-14.

10 Sean Davy, Managing Director, Capital Markets Division, Securities Industry and Financial Markets Association ("SIFMA") and Sullivan & Cromwell LLP ("Sullivan & Cromwell").

of the rules on family offices, sovereign entities, foreign employee retirement benefits plans, foreign investment companies and executive officers and directors of charitable organizations. FINRA is proposing to amend Rules 5130 and 5131 in response to the comments it received based on Regulatory Notice 17-14 as well as FINRA's experience with the rules.

Family Offices

The definition of "restricted person" in FINRA Rule 5130 includes portfolio managers, who are persons with the authority to buy or sell securities for, among other entities, a collective investment account.[11] The term "collective investment account"[12] currently excludes a "family investment vehicle," which, in turn, is defined as a legal entity that is beneficially owned solely by immediate family members.[13] Accordingly, under the rule, a person with the authority to buy or sell securities for an account that is beneficially owned only by "immediate family members," as defined, is not considered a portfolio manager based solely on that investment authority and, therefore, is not a restricted person. FINRA excluded such persons from the definition of "portfolio

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11 See FINRA Rule 5130(i)(10)(D) (Portfolio Managers). The definition of "portfolio manager" also includes any immediate family member of a portfolio manager who materially supports, or receives material support from, the portfolio manager. The term "material support" is defined as directly or indirectly providing more than 25 percent of a person's income in the prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with material support. See FINRA Rule 5130(i)(8).

12 See FINRA Rule 5130(i)(2).

13 See FINRA Rule 5130(i)(4). The term "immediate family member" is defined as a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support. See FINRA Rule 5130(i)(5).

manager" because family investment vehicles are often established for tax and estate planning purposes and do not manage money for unrelated persons.[14]

FINRA is proposing to expand the definition of "family investment vehicle" under Rule 5130 to include entities that are beneficially owned solely by "family members" and "family clients," which are terms used in the family office context and are defined in Advisers Act Rule 202(a)(11)(G)-1.[15] FINRA believes that an expansion that will further regulatory consistency without undermining investor protection is appropriate. As a result, the proposed rule change will incorporate these definitions into the definition of "family investment vehicle" under Rule 5130, subject to some limitations.

Family offices are entities established by families to manage their wealth and provide other services to family members and are excluded from the definition of "investment adviser" and, thus, are not subject to regulation under the Advisers Act.[16] The Advisers Act defines a "family office" as a company that, among other conditions, is wholly owned by family clients.[17] The term "family client"[18] includes, among other

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14 See Securities Exchange Act Release No. 42325 (January 10, 2000), 5 FR 2656, 2660 (January 18, 2000) (Notice of Filing File No. SR-NASD-99-60) ("Notice of New Issue Rule Filing").

15 See 17 CFR 275.202(a)(11)(G)-1.

16 See 15 U.S.C. 80b-2(a)(11)(G); Family Offices, Advisers Act Release No. 3220 (June 22, 2011), 76 FR 37983 (June 29, 2011).

17 17 CFR 275.202(a)(11)(G)-1(b)(2).

18 17 CFR 275.202(a)(11)(G)-1(d)(4).

defined persons, "family members"[19] as well as "key employees"[20] of the family office.

Although they overlap in significant respects, differences exist between a family investment vehicle under FINRA Rule 5130 and the family office concept under the Advisers Act. These differences create inconsistencies, which do not further the purposes of FINRA Rule 5130, with respect to the treatment of family offices under the two regimes. For example, the definition of "immediate family member" under FINRA Rule 5130 includes a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law and children, whereas the definition of "family member" under the Advisers Act includes lineal descendants of a common ancestor and the lineal descendants' spouses or spousal equivalents.[21] As a result, and by way of example, the inclusion of grandchildren or

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19 The term "family member" is defined as all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members. See 17 CFR 275.202(a)(11)(G)-1(d)(6).

20 The term "key employee" is defined as any natural person (including any key employee's spouse or spouse equivalent who holds a joint, community property, or other similar shared ownership interest with that key employee) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or its affiliated family office or any employee of the family office or its affiliated family office (other than an employee performing solely clerical, secretarial, or administrative functions with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office, provided that such employee has been performing such functions and duties for or on behalf of the family office or affiliated family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months. See 17 CFR 275.202(a)(11)(G)-1(d)(8).

21 See 17 CFR 275.202(a)(11)(G)-1(d)(6); supra note 19.

grandparents in a collective investment account will not disqualify the account from the family office designation under the Advisers Act on that basis, but would cause such an account to fall outside of the definition of "family investment vehicle" under FINRA Rule 5130.

Another difference is that the terms "immediate family member" and "family client" each address categories of non-family members; however, they do so in different ways. Specifically, the definition of "immediate family member" under FINRA Rule 5130 includes any individual to whom the person provides material support, which could encompass non-family members.[22] The definition of "family client" under the Advisers Act includes key employees of the family office, which may also cover non-family members but not necessarily only those non-family members who receive material support.[23] As a result of this difference, a person who has the authority to buy or sell securities for an account that is beneficially owned by family clients could be considered a portfolio manager based exclusively on that investment authority, and thus a restricted person under FINRA Rule 5130.

Given the significant overlap between these concepts, and FINRA's belief that the differences do not serve the purposes of the rule, FINRA is proposing to incorporate the definitions of "family member" and "family client" under the Advisers Act into the definition of "family investment vehicle" under Rule 5130, subject to some limitations. Specifically, the proposed rule change would amend FINRA Rule 5130(i)(4) to define a "family investment vehicle" as a legal entity that is beneficially owned solely by one or

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22 See supra note 13.

23 See supra note 20.

more of the following persons: (1) “immediate family members” as defined under FINRA Rule 5130(i)(5); (2) “family members” as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(6); or (3) “family clients” as defined under Advisers Act Rule 202(a)(11)(G)-1(d)(4);[24] provided, however, that where the beneficial owners of such an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity is an “immediate family member” as defined in FINRA Rule 5130(i)(5) or a “family member” as defined in Advisers Act Rule 202(a)(11)(G)-1(d)(6).

The first category would preserve the current exception in FINRA Rule 5130 and would provide relief from portfolio manager status under the rule for a person who has the authority to buy or sell securities for an account that is beneficially owned only by immediate family members. The second category would provide relief from portfolio manager status under the rule for a person who has the authority to buy or sell securities for an account that is beneficially owned only by “family members,” as defined in the Advisers Act. The third category would provide relief from portfolio manager status under the rule for a person who has the authority to buy or sell securities for an account that is owned only by “family clients,” as defined in the Advisers Act. In addition, the proposed rule change would provide relief to a legal entity that is beneficially owned by any combination of these categories.

However, the proposed rule change contains an important caveat where the beneficial owners are not solely immediate family members or family members under FINRA Rule 5130(i)(5) or Advisers Act Rule 202(a)(11)(G)-1(d)(6), respectively.

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[24] As noted above, the term “family client” includes not only family members but others, including key employees. See 17 CFR 275.202(a)(11)(G)-1(d)(4). Therefore, a family investment vehicle that is beneficially owned solely by family clients may include beneficial owners that are not family members.

Specifically, in such cases, the proposed rule change would only provide relief from portfolio manager status if the person who has the authority to buy or sell securities for the account is an "immediate family member," as defined in FINRA Rule 5130, or a "family member," as defined in the Advisers Act.[25] FINRA believes that it is necessary to impose this condition to safeguard against the abuses the rule is designed to address and to ensure that, for purposes of Rule 5130, the person who has the authority to buy or sell securities for the account is more closely aligned with the family than with key employees or others associated with the family office. FINRA believes that the proposed rule change strikes the proper balance between the treatment of family investment vehicles in FINRA Rule 5130 and the recognition of the family office exemption under the Advisers Act.

Sovereign Entities

The definition of "restricted person" in FINRA Rule 5130 includes, among others, direct and indirect owners of broker-dealers that are listed, or required to be listed, on Schedules A and B of Form BD (Uniform Application for Broker-Dealer Registration) and that have an ownership interest above specified thresholds.[26] The definition of "restricted person" includes owners of broker-dealers because the prohibition on

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25 Further, the proposed relief is only with respect to a person's status as a portfolio manager under FINRA Rule 5130. The proposed relief does not extend to a person who has a beneficial interest in a family investment vehicle and is a restricted person based on his or her other activities, such as an associated person of a member.

26 See FINRA Rule 5130(i)(10)(E) (Persons Owning a Broker-Dealer). FINRA Rule 5130 also provides an exception for an owner of a "limited business broker-dealer," which is defined as a broker-dealer whose authorization to engage in the securities business is limited solely to the purchase and sale of investment company/variable contracts securities and direct participation program securities. See FINRA Rules 5130(i)(7) and 5130(i)(10)(E).

purchases of new issues by a broker-dealer could be circumvented if the owners of a broker-dealer were permitted to purchase new issues.[27]

A sovereign wealth fund ("SWF") is a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation.[28] Occasionally, an SWF or sovereign nation (collectively, a "sovereign entity") may acquire a direct or an indirect ownership stake in a registered broker-dealer, requiring the sovereign entity to be listed on Schedule A or B of Form BD. Moreover, the sovereign entity's ownership interest could exceed the specified thresholds in FINRA Rule 5130(i)(10)(E), which would make the sovereign entity a restricted person.

Rule 5130(i)(10)(E) was not intended to encompass sovereign entities that acquire an ownership interest in a registered broker-dealer. Instead, as discussed above, the inclusion of owners of broker-dealers in the categories of restricted persons was intended to prevent circumvention of the prohibition on purchases of new issues by broker-dealers. FINRA believes that sovereign entities are unlikely to circumvent the rule's prohibition by reallocating new issue shares to broker-dealers and are inherently not designed for

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27 See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126, 62133 (October 31, 2003) (Order Approving File No. SR-NASD-99-60) ("New Issue Rule Approval Order").

28 There is no standard definition of the term "sovereign wealth fund," and the term is not defined under the federal securities laws. See, e.g., Celeste Cecelia Moles Lo Turco, Sovereign Wealth Funds: From Transparency to Sustainability, Sovereign Wealth Funds Law Centre, Bi-Annual Legal Report, October 2013 (noting the absence of a commonly accepted definition of "sovereign wealth fund").

such a purpose. Further, FINRA notes that significant investments by sovereign entities currently are subject to distinct legal and regulatory requirements.[29]

To address the unintended application of FINRA Rule 5130 to sovereign entities, the proposed rule change would exclude sovereign entities from the scope of owners of broker-dealers under Rule 5130(i)(10)(E). The proposed exclusion would not apply to affiliates of sovereign entities that are otherwise restricted. Accordingly, while a sovereign entity that owns a broker-dealer would not be considered a restricted person under the proposed rule change, the broker-dealer would continue to be a restricted person under FINRA Rule 5130.

The proposed rule change would also amend FINRA Rule 5130(i) (Definitions) to define the term "sovereign entity" for purposes of the rule as "a sovereign nation or a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation." The proposed rule change would further define the term "sovereign nation" as "a sovereign nation or its political subdivisions, agencies or instrumentalities."

Foreign Employee Retirement Benefits Plans

FINRA Rule 5130(c)(7) provides a general exemption from the rule's prohibitions for an Employee Retirement Income Security Act ("ERISA") benefits plan that is qualified under Section 401(a) of the Internal Revenue Code ("IRC"), provided that the

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29 For example, specific investments by sovereign entities in the United States that raise national security concerns are subject to review by the Committee on Foreign Investment in the United States (CFIUS). CFIUS is an interagency committee of the federal government chaired by the Department of the Treasury and authorized to review transactions that could result in control of a U.S. business by a foreign person to determine the effect of such transactions on the national security of the United States. See 31 CFR 800.

plan is not sponsored solely by a broker-dealer. Employee retirement benefits plans that are organized under and governed by foreign laws, even when similar to qualifying ERISA plans in all material respect, are not subject to ERISA and do not qualify for the exemption in FINRA Rule 5130(c)(7).[30] Because foreign employee retirement benefits plans may invest in assets on behalf of potentially hundreds of thousands of participants and beneficiaries, such plans may be unable to determine whether persons with a beneficial interest are restricted persons under FINRA Rule 5130. As a result, such plans may find it impossible to assess whether they may permissibly invest in new issues. Currently, FINRA Rule 5130 does not include a general exemption for foreign employee retirement benefits plans, although FINRA has previously acknowledged that such an exemption may be appropriate.[31]

In recent years, FINRA staff has granted several requests for exemption from the rule for foreign employee retirement benefits plans.[32] In each case, the foreign employee

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30 ERISA explicitly excludes from coverage employee benefit plans that are "maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens." 29 U.S.C. 1003(b)(4).

31 See Restrictions on the Purchase and Sale of Initial Equity Public Offerings Amendment No. 3, File No. SR-NASD-99-60 (March 19, 2001), http://www.finra.org/sites/default/files/RuleFiling/p000150.pdf.

32 See Letter from Gary L. Goldsholle, FINRA, to Edward A. Kwalwasser, Proskauer Rose LLP, dated December 7, 2010, http://www.finra.org/industry/exemptive-letters/december-7-2010-1200am; Letter from Afshin Atabaki, FINRA, to Christopher M. Wells, Proskauer Rose LLP, dated November 2, 2012, http://www.finra.org/industry/exemptive-letters/november-2-2012-1200am; Letter from Meredith Cordisco, FINRA, to Amy Natterson Kroll, Morgan, Lewis & Bockius LLP, dated July 23, 2015, http://www.finra.org/industry/exemptive-letters/july-23-2015-1200am; and Letter from Meredith Cordisco, FINRA, to Amy Natterson Kroll, Morgan, Lewis & Bockius LLP, dated April 16, 2018, http://www.finra.org/industry/exemptive-letters/april-16-2018-1200am.

retirement benefits plans were organized under and governed by foreign laws, had an extensive number of participants and beneficiaries and significant assets in the employer's retirement fund or family of retirement funds, and were administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries. Under these circumstances, the plans stated that the funds plainly could not serve as a conduit for restricted persons to purchase new issues. FINRA staff agreed that the concerns underlying the rule were not served in light of those circumstances and, as such, FINRA staff granted exemptions from FINRA Rule 5130 in connection with the foreign employee retirement benefits plans.

FINRA is proposing to codify this position by amending FINRA Rule 5130(c) (General Exemptions) to provide an exemption for an employee retirement benefits plan organized under and governed by the laws of a foreign jurisdiction, provided that such a plan or family of plans: (1) has, in aggregate, at least 10,000 participants and beneficiaries and $10 billion in assets; (2) is operated in a non-discriminatory manner insofar as a wide range of employees, regardless of income or position, are eligible to participate without further amendment or action by the plan sponsor;[33] (3) is administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries; and (4) is not sponsored by a broker-dealer. Under these conditions, FINRA believes that the plan(s) are not likely to serve as a conduit for circumventing the rule. In addition, FINRA believes that the rationale for

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33 The definition of "broad-based foreign retirement plan" under Section 409A of the IRC includes a substantially similar condition. See 26 CFR 1.409A-1(a)(3)(v)(A). Section 409A imposes restrictions on the deferral of compensation by employees, directors and independent contractors. Section 409A provides an exemption for compensation deferred under certain broad-based foreign retirement plans.

exempting ERISA benefits plans applies equally to foreign benefits plans when these conditions are met, and such plans should be afforded similar treatment under the rule.

Finally, FINRA Rule 5131(b)(2) sets forth the exemptions applicable to the spinning provision. The exemptions generally correspond to those under FINRA Rule 5130(c). Therefore, in conjunction with adding foreign employee retirement benefits plans to Rule 5130(c), FINRA is also proposing to amend Rule 5131(b)(2) to add a corresponding exemption to that rule. This proposed change will minimize unnecessary regulatory burdens without undermining the rule's stated objective, as the practice of spinning is unlikely to occur in connection with a covered person's beneficial interest in a foreign employee retirement benefits plan.

Alternative Conditions for Foreign Investment Company Exemption

Paragraph (c)(6) of FINRA Rule 5130 currently exempts sales to and purchases by an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; and (2) no person owning more than five percent of the shares of the investment company is a restricted person. The foreign investment company exemption is intended to apply to foreign investment companies that are similar to U.S. registered investment companies, which are currently exempt from FINRA Rule 5130's prohibitions.[34]

The purpose of the five percent condition is to prevent purchases of new issues by foreign investment companies with concentrated ownership interests of restricted

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[34] See FINRA Rule 5130(c)(1).

persons.[35] However, based on FINRA's experience with the rule, including informal discussions with industry groups and market participants in the years since the rule's adoption, FINRA understands that it is operationally impractical for a foreign investment company to determine whether an investor owns more than five percent of its shares where the investor acquires his or her interest through an intermediary that then holds the shares for multiple investors in an omnibus or nominee account as distinguished from an account that holds shares of a single investor. Further, an investor may acquire shares of a foreign investment company through multiple intermediaries or through multiple omnibus or nominee accounts at the same intermediary. In such cases, foreign investment companies are not able to satisfy the five percent condition.

When FINRA (then NASD) originally proposed the foreign investment company exemption as part of NASD Rule 2790 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings), the exemption included an additional condition that required the foreign investment company to have 100 or more investors.[36] During the rulemaking process, however, FINRA determined to simplify the exemption by eliminating the 100 investor requirement because the condition addressed the same concerns about concentration of ownership as the five percent condition.[37]

Given the operational issues raised by the five percent condition, FINRA is proposing to amend Rule 5130(c)(6) to provide the following two alternative methods to establish that a foreign investment company is widely held for purposes of the rule: (1)

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35 See New Issue Approval Order, 68 FR at 62138.

36 See Notice of New Issue Rule Filing, 5 FR at 2657.

37 See New Issue Approval Order, 68 FR at 62137.

the investment company has 100 or more direct investors; or (2) the investment company has 1,000 or more indirect investors.[38] FINRA believes that satisfying either of these two conditions would also assuage concerns about concentration of ownership. The proposed rule change would also add a condition to paragraph (c)(6) to ensure that the foreign investment company is not formed for the specific purpose of investing in new issues.

Therefore, as proposed, paragraph (c)(6) of FINRA Rule 5130 would exempt sales to and purchases by an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; (2) no person owning more than five percent of the shares of the investment company is a restricted person, the investment company has 100 or more direct investors, or the investment company has 1,000 or more indirect investors; and (3) the investment company was not formed for the specific purpose of investing in new issues.[39]

Exclusion for Foreign Offerings

As noted above, for purposes of FINRA Rules 5130 and 5131, the term "new issue" means any IPO of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular, subject to some

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[38] As noted above, in some jurisdictions, investors may invest through layers of intermediaries, with the legal ownership held by nominees. FINRA believes that a foreign investment company would be considered to be widely held on an indirect basis if it has 1,000 or more indirect investors.

[39] The proposed rule change also impacts an identical exemption cross referenced in paragraph (b)(2) of FINRA Rule 5131. The proposed rule change would not undermine the objectives of the spinning provision, as spinning would be unlikely to occur in connection with a foreign investment company when the proposed conditions are met.

exceptions.[40] Currently, the definition is not expressly limited to domestic securities offerings. Accordingly, the rules could apply to foreign offerings, even if a safe harbor is available for those offerings under the Securities Act, to the extent that a member or an associated person is participating in the offering or receiving allocations of new issues as an investor.[41]

In connection with Regulatory Notice 17-14, SIFMA and Sullivan & Cromwell requested that FINRA expressly exclude from Rules 5130 and 5131 offerings that are conducted pursuant to Regulation S, which provides a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities. SIFMA suggested that FINRA's goals of investor protection and fostering fair public capital markets are not present when members are participating in transactions conducted wholly offshore, and Sullivan & Cromwell stated that such a carve-out would provide clarity to the industry.[42] Some foreign jurisdictions may not restrict market participants, such as broker-dealers, from purchasing IPO shares for their own account. By prohibiting members and associated persons from purchasing IPO shares in foreign offerings, the current rule may indirectly impede the capital formation process in those foreign jurisdictions. Further, Regulation S offerings are currently excluded from the definition of "public offering" for purposes of FINRA Rules 5110 (Corporate Financing Rule —

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40 See Rules 5130(i)(9) and 5131(e)(7). The definition of "new issue" does not include, among others, offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act, or Securities Act Rule 504 if the securities are "restricted securities" under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder. See Rule 5130(i)(9)(A).

41 See Notice to Members 03-79 (December 2003) at n.13.

42 See SIFMA at 8; Sullivan & Cromwell at 7-8.

Underwriting Terms and Arrangements) and 5121 (Public Offerings of Securities With Conflicts of Interest). FINRA believes that an exclusion from Rules 5130 and 5131 for Regulation S offerings is also appropriate. In addition, FINRA believes that the exclusion should be extended to other offerings made outside of the United States or its territories and not just those that are expressly designated as Regulation S offerings.

Issuer-Directed Securities

FINRA Rules 5130(d) and 5131.01 each contain exemptive provisions for new issue allocations that are directed by an issuer, when specified conditions are met, because the regulatory concerns that the rules are designed to address are not present with respect to allocations of securities that are not controlled by an underwriter. However, these exemptions are not identical, in that FINRA Rule 5131 exempts allocations directed by affiliates and selling shareholders, while FINRA Rule 5130 does not.

In response to Regulatory Notice 17-14, SIFMA requested better alignment of these provisions.[43] FINRA agrees that a conforming change to FINRA Rule 5130(d) to more closely align the rule with the issuer-directed provision in FINRA Rule 5131.01 will provide regulatory consistency without negatively impacting investor protection or the integrity of the market for new issues and would not impact the spinning provision of Rule 5131. Specifically, the proposed rule change would amend paragraphs (d)(1) and (d)(2) of Rule 5130 to expand the exemption for issuer-directed securities to allocations directed by affiliates and selling shareholders of the issuer. The change will also clarify that the exemption applies to shares that are specifically directed in writing by the issuer.

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[43] See SIFMA at 7, n.10.

Exclusion for Unaffiliated Charitable Organizations

As noted above, paragraph (b) of FINRA Rule 5131 prohibits the practice of "spinning," which is the allocation of new issues to executive officers and directors of current and certain former or prospective investment banking clients. 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[44] or a covered non-public company,[45] or a person materially supported[46] by such executive officer or director, has a beneficial interest:[47] (1) if the company is currently an investment banking services client of the member or the member has received compensation from the company for investment banking services in the past 12 months; (2) if the 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 (3) on the

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44 FINRA Rule 5131(e)(1) defines "public company" as "any company that is registered under Section 12 of the Exchange Act or files periodic reports pursuant to Section 15(d) thereof." See FINRA Rule 5131(e)(1).

45 The term "covered non-public company" means any non-public company satisfying the following criteria: (1) 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; (2) shareholders' equity of at least $30 million and a two-year operating history; or (3) 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 FINRA Rule 5131(e)(3).

46 Similar to the definition in FINRA Rule 5130(i)(8), FINRA Rule 5131 defines "material support" to mean directly or indirectly providing more than 25 percent 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 FINRA Rule 5131(e)(6).

47 The term "beneficial interest" has the same meaning as in FINRA Rule 5130. See FINRA Rule 5131(e)(2).

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.

Because executive officers and directors are often in a position to hire 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 executive officers and directors from the company on whose behalf they must act. Industry groups and market participants have noted that these same concerns are not implicated in the case of executive officers and directors of charitable organizations. However, due to their asset size, some charitable organizations fall within the definition of a covered non-public company, making executives or directors of such organizations the subject of the rule's prohibition. FINRA believes that charitable organizations are not likely to generate significant investment banking business and, thus, there is a low risk, if any, that improper incentives would motivate a member's or an associated person's decision to allocate shares to the account of executive officers or directors of such organizations.

FINRA is proposing to amend paragraph (e)(3) of Rule 5131 (Definitions) to exclude unaffiliated charitable organizations, as that term is elsewhere defined in the rule,[48] from the definition of "covered non-public company." As a result of this proposed amendment, an executive officer or director of a charitable organization that is not

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

affiliated with the member allocating IPO shares would not become the subject of the rule's spinning provision solely on the basis of that service.

Addition of Anti-Dilution Provision to FINRA Rule 5131

FINRA Rule 5130 allows restricted persons that are existing equity owners of an issuer to purchase shares of the issuer in a public offering in order to maintain their equity ownership position. However, FINRA Rule 5131 currently does not include a similar anti-dilution provision for executive officers and directors who are subject to the prohibition on spinning set forth in Rule 5131(b). In response to Regulatory Notice 17-14, SIFMA urged FINRA to create symmetry between the rules by adding an anti-dilution provision for purposes of Rule 5131(b).[49] FINRA agrees that executive officers and directors of public companies and covered non-public companies who are subject to Rule 5131's spinning provision should be able to maintain the same equity ownership level that they held prior to the offering. Accordingly, the proposed rule change would amend Rule 5131 to add an anti-dilution provision to the rule similar to the one in Rule 5130(e), and would thus allow an executive officer or director of a public company or a covered non-public company (or a person materially supported by such a person) to retain the percentage equity ownership in the issuer at a level up to the ownership interest as of three months prior to the filing of the registration statement, provided that the other conditions are met.

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49 See SIFMA at 7, n.10. In addition, SIFMA requested that FINRA consider amending Rule 5131(d)(3) (Agreement Among Underwriters) relating to the treatment of returned shares to allow members the option of selling such shares in the secondary market and donating profits anonymously to an unaffiliated charity when a syndicate short position exists, consistent with a similar option when no syndicate short position exists. See SIFMA 8-9. FINRA considered this comment and has determined not to proceed with any changes to Rule 5131(d)(3).

If the Commission approves 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 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[50] 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 rule change will further these purposes by promoting capital formation and aiding member compliance efforts, while maintaining the integrity of the public offering process and investor confidence in the capital markets.

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

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

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, the economic baseline of analysis, the economic impact and the alternatives considered.

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50 15 U.S.C. 78o-3(b)(6).

1. Regulatory Need

Based upon FINRA's experience with Rules 5130 and 5131, as well as input from industry groups and market participants regarding practical and operational issues relating to the rules, FINRA is proposing amendments to reduce the regulatory burden on firms and remove certain impediments to capital formation without impacting investor protection. The proposed rule change aims to foster capital formation and to bring regulatory clarity and consistency. Specifically, FINRA is proposing to exempt additional persons from the scope of the rules, modify current exemptions to enhance regulatory consistency, address unintended operational impediments and exempt certain types of offerings from the scope of the rules.

2. Economic Baseline

The economic baseline for the proposed rule change is the current requirements and provisions of FINRA Rules 5130 and 5131, which are intended to protect the integrity of the public offering process. To this end, Rule 5130 sets forth categories of persons that are restricted from purchasing new issues. In addition, Rule 5131 places restrictions on the allocation of new issues to executive officers and directors of a member's current, former or prospective investment banking clients.

To assess the current economic baseline, FINRA has analyzed the current groups potentially affected by the various aspects of the proposed rule change. FINRA believes that there are thousands of family offices that, along with the family members and family clients served by those offices, are potentially impacted by the proposed rule change.[51] With respect to sovereign entities, there are approximately 195 independent states in the world,[52] many of which operate one or more sovereign wealth funds, and the number is believed to be on the rise.[53] FINRA understands that there are thousands of foreign pension plans (including both state- and privately-operated foreign plans) as well as millions of beneficiaries and participants of those plans. Similarly, FINRA understands that there are thousands of foreign investment companies and millions of investors in such companies. As of 2013, there were over one million organizations with Section 501(c)(3) status in the United States, though the number of charitable organizations that are large enough to fall within the current definition of "covered non-public company" in Rule 5131(e)(3) is likely smaller than that figure.[54]

3. Economic Impact

For purposes of this discussion, FINRA has identified the potentially material impacts of the proposed amendments on the affected parties.

FINRA believes that the proposed amendments to Rules 5130 and 5131 will remove unnecessary impediments to capital formation and lessen burdens in the public

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51 The exact number of family offices in the United States is not known; however, it is estimated that there are between 3,000 and 5,000 single family offices operating in the United States. See, e.g., Mary Pollack, Family Office Exchange, https://www.familyoffice.com/insights/how-many-family-offices-are-there-united-states.

52 See U.S. Department of State, Fact Sheet, Bureau of Intelligence and Research, Independent States in the World, https://www.state.gov/s/inr/rls/4250.htm.

53 See Sovereign Wealth Fund Institute, Sovereign Wealth Fund Rankings, http://www.swfinstitute.org/sovereign-wealth-fund-rankings/.

54 See National Center for Charitable Statistics, http://nccs.urban.org.

offering process. The proposed amendments will generally have a beneficial impact on issuers, underwriters and selling group members and certain categories of investors.

FINRA believes that a significant impact of the proposed amendments will be a reduction in both the costs and uncertainty in determining whether an investor is subject to the restrictions of Rules 5130 and 5131. The proposed rule change also may increase the pool of investors eligible to purchase new issues and, thus, encourage capital formation. FINRA believes that the proposed amendments would not alter the original purpose of Rules 5130 and 5131 in ensuring the integrity of a public offering.

FINRA Rule 5130 restricts members and associated persons from purchasing new issues for their own account or selling new issues to an account in which other restricted persons have a beneficial interest. Currently the definition of "restricted person" in Rule 5130(i)(10) captures certain persons that were not intended to be included in the definition. To address this issue, the proposed rule change would exempt from the definition of "restricted person": (1) a person with the authority to buy or sell securities for an account beneficially owned by a family office, subject to specified conditions; and (2) sovereign entities that acquire an ownership interest in a registered broker-dealer. These persons would benefit from the proposed rule change by eliminating their restrictions from purchasing new issues, thus increasing their set of potential investments. To the extent that new issues provide a unique risk-return profile from other types of securities investments, the inclusion of them in these persons' portfolios would be value enhancing. The proposed rule change would also better align with the Advisers Act's treatment of family offices.

FINRA Rule 5130 currently does not include a general exemption for foreign employee retirement benefits plans. Rather, FINRA staff has granted exemptive relief to certain foreign employee retirement benefits plans that have demonstrated that they cannot serve as a conduit for restricted persons to purchase new issues. The proposed rule change codifies the criteria upon which the staff granted exemptive relief. The proposed rule change would allow plans that meet specified criteria to invest in new issues without having to determine the eligibility of hundreds of thousands of participants and beneficiaries. By providing such plans additional flexibility to invest in new issues, the proposed rule change would enhance the investment options for their equity portfolios. The codification of the criteria would also improve regulatory uniformity and reduce compliance costs.

The foreign investment company exemption in FINRA Rule 5130(c)(6) is intended to apply to foreign investment companies that are similar to U.S. registered investment companies, which are currently exempt from FINRA Rule 5130's prohibitions. In order to satisfy the current exemption, the foreign investment company, among other conditions, must establish that no person owning more than five percent of the shares of the investment company is a restricted person. However, where an investor acquires his or her interest in a foreign investment company through an intermediary that then holds the shares for multiple investors in an omnibus or nominee account, the foreign investment company may not be able to determine whether the investor owns more than five percent of its shares. The proposed rule change would address this operational issue and create two alternative conditions that the foreign investment company have 100 or more direct investors or 1,000 or more indirect investors. The proposed alternative conditions would provide additional flexibility to foreign investment companies to demonstrate their eligibility for the exemption, and thereby enhance their ability to purchase new issues.

FINRA Rules 5130 and 5131 are primarily concerned with fostering fair public capital markets within the United States. However, because the definition of "new issue" is not expressly limited to domestic offerings, the rules could apply to foreign offerings, even if a safe harbor is available for those offerings under the Securities Act, if a member or an associated person is participating in the offering or receiving allocations as an investor. The proposed rule change would clarify the scope of Rules 5130 and 5131 by excluding Regulation S offerings and other offerings made outside of the United States or its territories from the scope of the rules. The proposed rule change would also harmonize Rules 5130 and 5131 with other FINRA rules relating to securities offerings, FINRA Rules 5110 and 5121, which currently exclude foreign offerings. FINRA believes that the proposed rule change will remove the burdens associated with complying with both U.S. and foreign regulatory regimes relating to public offerings and will lead to an increase in the pool of eligible investors for offshore offerings of new issues without undermining the fairness of U.S. public capital markets. Further, an increase in the pool of eligible investors could lead to a lower cost of capital for issuers engaged in foreign offerings.

The issuer-directed provisions in FINRA Rules 5130 and 5131 are similar, but have differences that do not further the purposes of the rules. The proposed rule change would better align the issuer-directed provisions of Rules 5130 and 5131, provide regulatory consistency across the rules and remove the compliance costs of applying different standards, without negatively impacting the purposes of the rules.

Charitable organizations may not generate significant investment banking business. However, due to their asset size, some charitable organizations may fall within the definition of a "covered non-public company" under FINRA Rule 5131, making executives or directors of such organizations the subject of the rule's prohibition. FINRA believes that the concerns addressed by the rule are not implicated with respect to executive officers or directors of charitable organizations that are not affiliated with a member. The proposed rule change, therefore, would exclude "unaffiliated charitable organizations," as currently defined in Rule 5131, from the definition of "covered non-public company." FINRA believes that this proposed change will ease the burden on firms as they will no longer be required to consider whether an investment banking relationship exists vis-à-vis the member and an unaffiliated charitable organization when an individual with a beneficial interest in an account is an executive officer or director (or materially supported by such a person) of such an organization. FINRA believes that the proposed rule change would provide benefits by reducing the uncertainty of whether a particular relationship is problematic and by reducing the time and costs associated with making that determination. The proposed rule change will also impact individuals who are executive officers or directors of unaffiliated charitable organizations (and those materially supported by such individuals) as they will no longer be subject to the rule's prohibitions on that basis. Finally, the proposed rule change will benefit issuers by increasing the pool of prospective investors, thus potentially leading to a lower cost of capital for the issuers.

Finally, the anti-dilution provision of FINRA Rule 5130 allows restricted persons to maintain the equity ownership interest they had before a public offering, but FINRA Rule 5131 has no similar provision. An unintentional result of this is that officers or directors of public companies and covered non-public companies may experience diminished ownership interest upon a public offering and a transfer of wealth from them to those investors that are able to purchase shares in the new offering. The proposed rule change would add an anti-dilution provision to Rule 5131 similar to that of Rule 5130 and ameliorate this inconsistency. This would reduce the regulatory uncertainty and create a level playing field for all investors.

4. Alternatives Considered

FINRA considered various alternatives to the proposed rule change. When assessing foreign pension plans, FINRA considered whether to impose a requirement that the plan, or family of plans, have a greater number of participants and beneficiaries than the proposed 10,000. However, the 10,000 participants and beneficiaries figure is appropriate, particularly when viewed along with the condition that the plan have at least $10 billion in assets, and exceeds participant thresholds contained in other parts of the rule.[55]

With respect to the foreign investment company exemption, FINRA considered allowing foreign investment companies to establish dilution of the fund solely by satisfying the current five percent condition. However, allowing the foreign investment company to satisfy either the five percent condition, the 100 or more direct investor

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55 See, e.g., Rule 5130(c)(3)(A) (exempting sales to and purchases of new issues by an insurance company general, separate or investment account, provided that, among other conditions, the account is funded by premiums from 1,000 or more policyholders).

condition, or the 1,000 or more indirect investor condition, in addition to the other conditions, achieves the purpose of the rule while providing greater flexibility for foreign investment companies to meet the conditions of the exemption.

In assessing the appropriateness of an exclusion for charitable organizations from the definition of "covered non-public company" in Rule 5131(e)(3), FINRA considered whether to extend the exclusion to all nonprofit organizations, including, for example, civic leagues or social welfare entities organized pursuant to other sections of the IRC.[56] However, FINRA determined not to extend the definition in this manner and notes that, unlike Section 501(c)(3) organizations, such organizations are not prohibited from substantially engaging in other activities. In addition, limiting the exclusion to Section 501(c)(3) charitable organizations is consistent with the treatment of such entities in the context of other provisions of Rules 5130 and 5131.[57]

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

Written comments were neither solicited nor received on the proposed rule change. As noted above, in April 2017, FINRA published Regulatory Notice 17-14 seeking comment on the effectiveness and efficiency of its rules relating to the capital-raising process, including FINRA Rules 5130 and 5131 generally, and, in response, two

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56 Civic leagues and social welfare organizations may be organized pursuant to Section 501(c)(4) of the IRC.

57 See, e.g., Rule 5130(c)(9) (exempting Section 501(c)(3) tax exempt charitable organizations from Rule 5130); Rule 5131(e)(9) (defining unaffiliated charitable organization as a tax-exempt entity organized under Section 501(c)(3) of the IRC).

commenters requested that FINRA consider certain amendments to Rules 5130 and 5131.[58]

In addition to comments received in response to Regulatory Notice 17-14, FINRA has experience with the rules since their adoption that has informed the proposed rule change. During that time, FINRA has generally engaged in discussions with industry groups and market participants regarding: (1) persons with authority to buy or sell securities on behalf of accounts beneficially owned by family offices; (2) sovereign entities that own broker-dealers; (3) foreign employee retirement benefits plans; (4) executive officers and directors of unaffiliated charitable organizations; and (5) foreign investment companies whose shares are held in omnibus or nominee accounts. The proposed rule change also reflects FINRA's experience and years of informal discussions with market participants.

FINRA believes that the proposed rule change strikes the appropriate balance by promoting capital formation and aiding member compliance efforts while maintaining the protections that Rules 5130 and 5131 are designed to provide, as discussed above.

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:

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[58] See supra notes 9 and 10.

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

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

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-2019-022 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2019-022. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2019-022 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.[59]

Jill M. Peterson
Assistant Secretary

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[59] 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

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5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

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5130. Restrictions on the Purchase and Sale of Initial Equity Public Offerings

(a) through (b) No Change.

(c) General Exemptions

The general prohibitions in paragraph (a) of this Rule shall not apply to sales to and purchases by the following accounts or persons, whether directly or through accounts in which such persons have a beneficial interest:

(1) through (5) No Change.

(6) An investment company organized under the laws of a foreign jurisdiction, provided that:

(A) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; [and]

(B) no person owning more than 5% of the shares of the investment company is a restricted person[;], the investment company has 100 or more direct investors, or the investment company has 1,000 or more indirect investors; and

(C) the investment company was not formed for the specific purpose of investing in new issues;

(7) No Change.

(8) An employee retirement benefits plan organized under and governed by the laws of a foreign jurisdiction, provided that such plan or family of plans:

(A) has, in aggregate, at least 10,000 plan participants and beneficiaries and $10 billion in assets;

(B) is operated in a non-discriminatory manner insofar as a wide range of employees, regardless of income or position, are eligible to participate without further amendment or action by the plan sponsor;

(C) is administered by trustees or managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries; and

(D) is not sponsored solely by a broker-dealer;

[(8)](9) A state or municipal government benefits plan that is subject to state [and/]or municipal regulation;

[(9)](10) A tax exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code; or

[(10)](11) A church plan under Section 414(e) of the Internal Revenue Code.

(d) Issuer-Directed Securities

The prohibitions on the purchase and sale of new issues in this Rule shall not apply to securities that:

(1) are specifically directed in writing by the issuer, its affiliates, or selling shareholders, to persons that are restricted under the Rule; provided, however, that securities directed by an issuer, its affiliates, or selling shareholders, may not be sold to or purchased by:

(A) a broker-dealer; or

(B) an account in which any restricted person specified in paragraphs (i)(10)(B) or (i)(10)(C) of this Rule has a beneficial interest, unless such person, or a member of his or her immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent. Also, for purposes of this paragraph (d)(1) only, a parent/subsidiary relationship is established if the parent has the right to vote 50% or more of a class of voting security of the subsidiary, or has the power to sell or direct 50% or more of a class of voting security of the subsidiary;

(2) are specifically directed in writing by the issuer, its affiliates, or selling shareholders, and are part of an offering in which no broker-dealer:

(A) underwrites any portion of the offering;

(B) solicits or sells any new issue securities in the offering; and

(C) has any involvement or influence, directly or indirectly, in the issuer's allocation decisions with respect to any of the new issue securities in the offering;

(3) are part of a program sponsored by the issuer or an affiliate of the

issuer that meets the following criteria:

(A) the opportunity to purchase a new issue under the program is offered to at least 10,000 participants;

(B) every participant is offered an opportunity to purchase an equivalent number of shares, or will receive a specified number of shares under a predetermined formula applied uniformly across all participants;

(C) if not all participants receive shares under the program, the selection of the participants eligible to purchase shares is based upon a random or other non-discretionary allocation method; and

(D) the class of participants does not contain a disproportionate number of restricted persons as compared to the investing public generally; or

(4) are directed <u>in writing</u> to eligible purchasers who are otherwise restricted under the Rule as part of a conversion offering in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering.

(e) through (h) No Change.

(i) Definitions

(1) through (3) No Change.

(4) "Family investment vehicle" means a legal entity that is beneficially owned solely by <u>one or more of the following persons:</u>

<u>(A)</u> immediate family members[.]<u>;</u>

(B) family members, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act; or

(C) family clients, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act.

However, where the beneficial owners of an entity include family clients, the person who has the sole authority to buy or sell securities for such an entity must be an immediate family member, as defined in paragraph (i)(5) of the Rule, or a family member, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act, for the entity to be considered a family investment vehicle under the Rule.

(5) through (8) No Change.

(9) "New issue" means any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular. New issue shall not include:

(A) offerings made under Regulation S of the Securities Act or otherwise made outside of the United States or its territories, or offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act, or Securities Act Rule 504 if the securities are "restricted securities" under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;

(B) through (J) No Change.

(10) "Restricted person" means:

(A) through (D) No Change.

(E) Persons Owning a Broker-Dealer

(i) through (vi) No Change.

(vii) Subparagraphs (E)(i) through (v) shall not apply to a sovereign entity.

(11) "Sovereign entity" means a sovereign nation or a pool of capital or an investment fund owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of the sovereign nation.

(12) "Sovereign nation" means a sovereign nation or its political subdivisions, agencies or instrumentalities.

(j) No Change.

5131. New Issue Allocations and Distributions

(a) No Change.

(b) Spinning

(1) No Change.

(2) The prohibitions in this paragraph shall not apply to allocations of shares of a new issue to any account described in Rule 5130(c)(1) through (3) and (5) through ([10]11), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.

(c) through (d) No Change.

(e) Definitions

(1) through (2) No Change.

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

(4) through (9) No Change.

(f) No Change.

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

.01 through .03 No Change.

.04 Anti-Dilution Provisions. The prohibitions of paragraph (b) above shall not apply to an account in which an executive officer or director of a public company or a covered non-public company, or a person materially supported by such executive officer or director, has a beneficial interest that meets the following conditions:

(a) the account has held an equity ownership interest in the issuer, or a company that has been acquired by the issuer in the past year, for a period of one year prior to the effective date of the offering;

(b) the allocation of the new issue to the account shall not increase the account's percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement in connection with the offering;

(c) the allocation of the new issue to the account shall not include any special terms; and

(d) the new issue allocated pursuant to this Supplementary Material .04 shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

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