Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 152

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

File No. * SR 2026 - * 002
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) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

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)

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 Rules 5110 (Corporate Financing Rule - Underwriting Terms and Arrangements) and 5123 (Private Placements of Securities)

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 * Micah Last Name * Hauptman

Title * Associate General Counsel

E-mail * micah.hauptman@finra.org

Telephone * (202) 728-8123 Fax

Signature

Pursuant to the requirements of the Securities Exchange of 1934, Financial Industry Regulatory Authority has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 01/22/2026

By Joseph Savage
(Name *)

(Title *)
Vice President & Associate General Counsel

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

Joseph Savage
Digitally signed by Joseph Savage
Date: 2026.01.22 14:42:17 -05'00'

Required fields are shown with yellow backgrounds and astericks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information *

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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 *

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FINRA-2026-002 Exhibit 1.docx

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 Advanced Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

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FINRA-2026-002 Exhibit 2a.pdf
FINRA-2026-002 Exhibit 2b.docx
FINRA-2026-002 Exhibit 2c.pdf

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 Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

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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 Sent As Paper Document

Exhibit 4 - Marked Copies

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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

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FINRA-2026-002 Exhibit 5.docx

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

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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" or "SEA" or "Exchange Act"),[1] the Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend FINRA Rules 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) and 5123 (Private Placements of Securities). The proposed amendments to Rule 5110 would improve and clarify the valuation method for securities considered underwriting compensation, add new exclusions from underwriting compensation that codify exemptions FINRA staff has issued, and include minor changes to improve the operation of the rule. The proposed amendments to Rule 5123 would expand available exemptions to include offerings sold to investors meeting the categories of accredited investor for certain family offices and certain entities with assets under management in excess of $5,000,000, consistent with the Commission's treatment of those categories.

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.

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

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

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

(a) Purpose

Background

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in connection with the public offering of securities. Moreover, Rule 5110 continues to be important to promoting investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

Rule 5110 requires a member that participates in a public offering to file documents and information with FINRA about the underwriting terms and arrangements.[2] FINRA's Corporate Financing Department ("Department") reviews this information prior to the commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of the applicable FINRA rules.[3]

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2 The following are examples of public offerings that are routinely filed: (1) initial public offerings ("IPOs"); (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs as defined in FINRA Rule 2310(a)(4) (Direct Participation Programs); (6) exchange offers; (7) offerings pursuant to SEC Regulation A; and (8) offerings by closed-end funds.

3 FINRA does not approve or disapprove an offering; rather, the review relates solely to the FINRA rules governing underwriting terms and arrangements and does not purport to express any determination of compliance with any federal or state laws, or other regulatory or self-regulatory requirements regarding the

The unregistered offering market also is an important source of capital for American businesses, including small and midsize companies. Rule 5123 plays a critical role in providing information that assists FINRA in the identification of potential trends and rule violations in the private placement market.

In general, Rule 5123 requires members to file with FINRA any private placement memorandum, term sheet or other offering document, and any retail communication that promotes or recommends a private placement, including any material amended versions thereof, used in connection with a private placement of securities within 15 calendar days of the date of first sale, unless the member can rely on an applicable exemption from the rule. Rule 5123 contains an exemption from filing for offerings sold to certain types of sophisticated institutional investors that qualify as "accredited investors" under Rule 501 of the Securities Act of 1933 ("Securities Act").[4]

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offering. A member may proceed with a public offering only if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements. See Rule 5110(a)(1)(C)(ii).

[4] These "institutional" accredited investors are:

- banks and savings and loan associations; registered broker-dealers; investment advisers; insurance companies; investment companies; business development companies; Small Business Investment Companies; Rural Business Investment Companies; state employee benefit plans with assets in excess of $5 million; or ERISA employee benefit plans, if the investment decision is made by a plan fiduciary, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5 million, or if a self-directed plan, with investment decisions made solely by persons that are accredited investors (see Rule 501(a)(1));
- private business development companies (see Rule 501(a)(2));
- organizations described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited

These institutional accredited investors have sufficient sophistication to warrant an exemption from the rule.

In 2020, the SEC amended the definition of accredited investor to include two additional types of institutional entities.[5] The amendments updated the definition of accredited investor to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in private capital markets.

Overview of Proposed Amendments

The proposed amendments to Rule 5110 would improve and clarify parts of the rule covering the valuation method for securities deemed underwriting compensation. The proposed amendments would also include new exclusions from underwriting compensation that codify exemptions FINRA staff has issued and clarifications of other provisions, all of which would further promote capital formation without lessening investor or issuer protection. In addition, the proposed amendments would include several minor changes to improve the operation of the rule and address common questions encountered during the review process.

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liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million (see Rule 501(a)(3)); and

- trusts with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) (see Rule 501(a)(7)).

5 See Accredited Investor Definition, Securities Exchange Act Release 89669 (August 26, 2020), 85 FR 64234 (October 9, 2020), including new categories of accredited investor under Rule 501(a)(9) and (a)(12).

The proposed amendments to Rule 5123 would add two types of entities that would qualify under the existing filing exemption under Rule 5123, consistent with the Commission's treatment of the accredited investor definition.

Rule 5110 Proposed Amendments

Valuation Method for Securities Acquisitions Considered Underwriting Compensation

Currently, when participating members[6] acquire securities that are deemed underwriting compensation, the value of the securities is based on either the public offering price per security or the price paid per security on the date of acquisition if a "bona fide public market" exists for the security.[7] The definition of "bona fide public market" requires that the securities be traded on a national securities exchange and relies on SEC Regulation M's definitions of average daily trading volume and public float.[8] FINRA understands that members have experienced challenges determining whether a security had a "bona fide public market" on the acquisition date using this complex, multipart definition. When a security does not meet the definition, and does not have a public offering price, it cannot be valued under the rule and is therefore considered indeterminate compensation, which is prohibited under Rule 5110(g)(1).

The proposed rule change would amend Rule 5110(c)(2) and (3) by

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6 The term "participating member" means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer. See Rule 5110(j)(15).

7 See Rule 5110(c).

8 See Rule 5121(f)(3).

replacing "bona fide public market" with a valuation method in which the calculation is more predictable, based on the closing market price of a security traded on a registered national securities exchange or a "designated offshore securities market"[9] on the date of acquisition. Using this readily available market data would greatly simplify application of the rule.

Exclusions from Underwriting Compensation for Certain Securities Acquisitions

The proposed rule change is intended to foster capital raising by providing additional exclusions from underwriting compensation for certain types of investments by participating members in anticipation of, or concurrently with, a public offering. These proposed amendments cover (1) debt-for-equity exchanges; (2) capital investments for direct participation programs ("DPPs")[10] and unlisted real estate investment trusts ("REITs");[11] and (3) non-convertible preferred securities, and describe factors FINRA has considered regarding whether to exclude securities acquisitions from being deemed underwriting compensation when such acquisitions are in connection with bona fide financing that would benefit the issuer and investors. Each proposed amendment is discussed below.

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9 See Securities Act Rule 902(b).

10 See Rule 2310(a)(4).

11 See Rule 2231(d)(4).

Debt-for-Equity Exchanges

Rule 5110 does not now provide an exclusion from underwriting compensation for securities acquired by affiliates of underwriters in connection with debt-for-equity exchange transactions. Debt-for-equity exchanges have increasingly occurred in recent years and provide favorable tax treatment and economic benefits to issuers.[12] A debt-for-equity exchange is composed of a series of transactions in which a lender acquires equity securities of the issuer, often referred to as exchange shares, in return for a cash loan. The exchange shares are subsequently or concurrently registered and offered by underwriters in a public offering. The offering proceeds are used, in whole or part, as repayment of the loan. When the lender is an affiliate of an underwriter, it falls within the definition of participating member, and the equity securities acquired by the affiliated lender for making the loan fall within the definition of underwriting compensation.

The proposed rule change would add new Supplementary Material .01(b)(23) to provide relief from such exchanges being deemed underwriting compensation if the equity acquired is part of a transaction that provides economic and tax benefits to the issuer and meets the following conditions:

- the affiliated member subsequently offered all of the equity securities the lender acquired in a firm commitment offering following the debt exchange;[13]

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12 Pursuant to Rule 5110(i), FINRA received 15 exemption requests for debt-for-equity transactions from 2022 through 2024.

13 Typically, lenders and affiliated members coordinate to satisfy this condition. However, even if they do not coordinate, the affiliated member can satisfy the condition with the subsequent offering.

- the parties determined the terms of the debt exchange and the subsequent equity issued through arms' length negotiations based on the market price of the equity;[14] and
- the affiliated member negotiated customary compensation for the subsequent equity offering.

The proposed rule change would facilitate capital formation by providing consistent regulatory treatment of a common financing strategy issuers employ.

Capital Investments for DPPs and REITs

Rule 5110 does not now provide an exclusion from underwriting compensation for capital investments in exchange for an equity stake made by affiliates of underwriters concurrently with or in advance of a public offering. Such investments are common in DPP and REIT offerings to provide the initial or subsequent equity capital or financing needed by an issuer.

The proposed rule change would add new Supplementary Material .01(b)(24) to provide relief from such transactions by setting out the conditions for excluding capital investments from being deemed underwriting compensation. Supplementary Material .01(b)(24) would work as a self-operating exclusion and would not limit when the transactions could occur. The conditions for Supplementary Material .01(b)(24) apply to

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[14] Past exemptions that have been granted consistent with the conditions of this proposed Supplementary Material involved operating companies with equity listed on a national securities exchange with a market price and did not involve an IPO or a spinoff. Member firms intending to participate in transactions that do not align with the terms of this Supplementary Material may, as with any transaction subject to Rule 5110, request exemptive relief pursuant to FINRA Rule 5110(i) and the Rule 9600 Series.

securities acquired before or during the distribution of an offering by a participating member in the issuer or an affiliated entity and would require that:

- the capital investments are disclosed in the prospectus;
- the offering and the securities acquired in the capitalization transaction are valued and priced based on net asset value ("NAV");[15]
- the offering is subject to the requirements of Rule 2310 (Direct Participation Programs); and
- the securities acquired are restricted for a period of 180 days following the commencement of sales.

These conditions are intended to promote transparency, ensure fair valuation, and address potential conflicts of interest in these transactions.

Non-Convertible Preferred Securities

Rule 5110 provides that non-convertible or non-exchangeable debt securities and derivative instruments acquired by any participating member in a transaction related to a public offering at a fair price[16] are considered underwriting compensation but have no compensation value.[17] Because both non-convertible debt and non-convertible preferred

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15 Capitalization transactions occurring before the issuer has material assets would be deemed to occur at or above NAV.

16 See Rule 5110.06(b).

17 See Rules 5110(c)(5) and 5110.06. As a general rule, compensation that cannot be valued is prohibited. See Rule 5110(g)(1). Under this exclusion, treating these transactions as compensation without value permits the participating member to receive the securities (as long as they are received at a fair price) while still allowing FINRA the ability to review the transactions to determine whether they were, indeed, received at a fair price. If they were not, the value of underwriting compensation that is attributed to these securities is the difference between their fair price and their actual price.

securities cannot be converted to common stock and provide predetermined payments to holders, resulting in fixed sources of income, FINRA views them as equivalent for purposes of the Rule 5110 exclusion and, accordingly, the proposed rule change would treat them in a comparable manner as long as non-convertible preferred securities are acquired at a fair price. This rule change would facilitate capital formation by providing members with predictable regulatory treatment and benefit issuers through the capital investments made in exchange for non-convertible preferred securities from affiliates of members that participate in public offerings.

Changes to Improve Operation of Rule 5110

The proposed rule change would make other minor modifications to Rule 5110 based on FINRA's experience reviewing filings that FINRA believes would improve the operation of the rule and reduce the number of questions raised by filers during the review process. For example, Rule 5110(g)(5)(B) permits termination fees or the receipt of compensation in the form of rights of first refusal in connection with a public offering that is terminated when specific requirements are met that protect the issuer (i.e., they are not deemed to be prohibited unreasonable terms or arrangements). Increasingly, members negotiate payments often described as "tail fees" in engagement letters that are similar to the terms and requirements for termination fees or rights of first refusal. Because tail fees provide compensation in the event of a subsequent financing from investors introduced by a member following the termination of an agreement, these payments are comparable to termination fees for purposes of Rule 5110. The proposed rule change would amend Rule 5110(g)(5)(B) to clarify that the same requirements would

apply to such fees.[18] If these requirements are not met, tail fees would constitute unreasonable arrangements under Rule 5110.

Proposed Amendments to Rule 5123

The proposed rule change would add two types of entities to the filing exemption under Rule 5123, consistent with the Commission's treatment of the accredited investor definition. As stated above, in August 2020, the Commission adopted amendments to the definition of "accredited investor" under Rule 501[19] to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in private capital markets. These changes included:

- any entity, of a type not listed in paragraphs (a)(1), (2), (3), (7), or (8) of Rule 501, not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;[20] and
- any "family office" with assets under management in excess of $5,000,000, that is not formed for the specific purpose of acquiring the securities offered and its

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18 These requirements are that: (i) the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement; (ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal; (iii) the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and (iv) the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer. See Rule 5110(g)(5)(B).

19 See SEC Accredited Investor Definition Release, supra note 5.

20 See 17 CFR 230.501(a)(9).

prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.[21]

Adding these two types of entities to the existing exemption would establish consistency with the purpose of Rule 5123. FINRA believes that the investors described above possess a level of sophistication and expertise that is similar to the institutional accredited investors currently exempted under Rule 5123 and generally do not need the additional protections and oversight provided through the filing requirements. FINRA notes that qualified purchasers, which currently are covered in another exemption from Rule 5123's filing requirements, are defined under the Investment Company Act of 1940 and the rules thereunder ("Investment Company Act") to include natural persons or certain companies that own not less than $5,000,000 in investments.[22] The two entities above have a similar financial threshold, which indicates an equivalently high level of sophistication to justify exemption from Rule 5123.[23]

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.

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21 See 17 CFR 230.501(a)(12).

22 See Investment Company Act Section 2(a)(51).

23 The Commission's August 2020 accredited investor amendments promulgated additional categories of accredited investors, including natural persons holding professional certifications and designations or other credentials, knowledgeable employees of private funds, and certain family clients, which FINRA is not proposing to add in these amendments.

(b) Statutory Basis

FINRA believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Act,[24] which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The proposed amendments to Rules 5110 would enhance the efficiency of FINRA rules and further support capital formation. For example, the proposed amendments to Rule 5110 would improve and clarify the application of Rule 5110 and align the rule with current practices relating to underwriting compensation. The proposed amendments to Rule 5110 regarding valuation of securities that are considered underwriting compensation would replace a valuation process that members have stated is unnecessarily complex and cumbersome with a simpler, more straightforward valuation process, which would provide predictability and efficiency to members' valuation processes. The proposed amendments to Rule 5110 regarding new exclusions from underwriting compensation that codify exemptions FINRA staff has issued would provide additional flexibility and clarity for member firms that would reduce the need for and cost associated with certain participating members requesting exemptions from FINRA, reduce the amount of time for FINRA's review of these filings, allow issuers to access capital markets faster, and enhance the transparency and efficiency of the

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[24] 15 U.S.C. 78o-3(b)(6).

regulatory process.[25] The codification of these exemptions as exclusions may lead some members that would not request an exemption under the baseline to use an exclusion, generating additional or greater investments in issuers, thereby increasing access and options to capital raising.

The proposed amendments to Rule 5110 also would maintain important protections for issuers and investors participating in offerings. The proposed valuation method would continue to ensure that securities that are acquired by underwriters are valued fairly. In addition, the proposed exclusions are narrowly tailored and based on exemptive relief FINRA has provided, which have worked well for issuers and investors.[26] The proposed rule change also would not decrease FINRA's ability to oversee underwriting terms and arrangements. In totality, the proposed rule change would reduce the administrative and operational burdens for members and FINRA, promote regulatory efficiency, and enhance market functioning while maintaining issuer and investor protection.

The proposed amendments to Rules 5123 also would enhance the efficiency of FINRA rules and further support capital formation. By expanding the scope of private placements that are exempt from the requirement of Rule 5123, members that participate in these offerings would no longer be required to comply with Rule 5123.

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[25] FINRA received 21 requests for exemptions for capital investments and debt-for-equity transactions from 2022 through 2024. Each request required substantial analysis by FINRA staff and discussions with the member firm, resulting in a longer review of a potential offering in order to consider the request.

[26] Rule 5110.01(b)(23) – (24) codifies the factors and factual circumstances FINRA has consistently considered when granting these exemptions.

In addition, the proposed amendments to Rule 5123 would not diminish investor protection. The institutional investors who would be covered by the filing exemption possess a level of sophistication and expertise that is similar to the institutional accredited investors currently exempted under Rule 5123 and generally do not need the additional protections and oversight provided through the filing requirements. Non-institutional accredited investors who may not possess the same level of sophistication and expertise as institutional investors would continue to receive the protections of the Rule 5123 filing requirement, with FINRA reviewing private placement offerings sold to these investors and helping detect misconduct in the private placement process, thereby promoting investor protection.

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

FINRA does not believe that the proposed rule changes 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 to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

Regulatory Need

As discussed earlier, the current approach to valuation of securities that are considered underwriting compensation under current Rule 5110 can be complex, creating

unnecessary burdens for members and uncertainty on whether they are permitted to acquire certain securities or required to receive a different form of compensation. The proposed rule change would provide a simpler, more straightforward approach. In addition, certain transactions require participating members to request exemptions from FINRA. This approval process can increase the amount of time for issuers to access capital markets. By codifying existing FINRA staff positions, the proposed rule change would reduce such requests by replacing existing requirements with more practical and transparent alternatives. The proposed rule change would also expand the exemptions available in Rule 5123 and better align FINRA rules with SEC rules relating to the treatment of institutional accredited investors.

Economic Baseline

The economic baseline for the proposed rule changes is the existing regulation framework of public offerings and private placements subject to regulatory oversight under Rules 5110 and 5123 and their interpretations and implementation by FINRA. The economic baseline also includes industry practices relating to and compliance with these existing regulations and other relevant regulatory frameworks.

With respect to public offerings subject to Rules 5110, FINRA evaluated filing information to assess members' participation in public offerings required to be filed with FINRA. FINRA notes that the observations addressed here do not include observations in which members may have relied on a filing exemption under Rule 5110(h)(1). FINRA received 3,711 new filings under Rule 5110 during 2022-2024. The annual number of new filings ranged from 1,398 in 2022 to 1,209 in 2024, with an average number of 1,237 filings per year. These filings represented underwriting, allocation, distribution, advisory

and other investment banking services in connection with a public offering conducted by 333 members, to the extent the member's participation in the public offering is required to be provided. The average and median number of filings in which a member participated was 15 and three during the period, respectively. The aggregate amount of offering proceeds in association with these filings was over $781 billion, with a median value of approximately $50 million per filing.

Certain proposed changes to Rule 5110 specifically relate to public offerings with capital investments for DPPs and REITs, debt-for-equity transactions, and securities acquired by a participating member without a "bona fide public market." FINRA collected information on exemption requests submitted by members in non-shelf filings related to these three sets of acquisitions. An analysis of this data finds that among the 2,402 new non-shelf offerings filed under Rule 5110 during 2022-2024, six (0.25 percent) offerings requested exemptions relating to capital investments for DPPs and REITs, 15 (0.62 percent) offerings requested exemptions relating to debt-for-equity transactions, and 12 (0.5 percent) offerings requested exemptions relating to valuing securities without a bona fide public market.[27] A majority of these exemptions were granted after FINRA took into consideration all relevant factors.

With respect to private placement offerings under Rule 5123, FINRA collected information detailing 8,485 unique filings under Rule 5123 submitted by 525 members during the above period. The annual number of unique filings ranged from 3,807 in 2022

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[27] See Rule 5110(i). "Pursuant to the Rule 9600 Series, FINRA, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest."

to 2,344 in 2024, with an average number of 2,828 filings per year. Among the 8,485 unique filings, 7,599 (90 percent) had projected proceeds totaling $388 billion with a median value of $10 million per filing. Projected proceeds were reported as unknown for the remaining filings. The average and median number of these filings submitted per participating member during the above period were 15 and three, respectively.

Economic Impact

The proposed rule change would directly impact members, issuers and investors that participate in public offerings and private placements. This economic impact analysis considers the significant impacts associated with specific rule changes relating to underwriting compensation and private placement offerings.

Anticipated Benefits of Proposed Amendments to Rule 5110

Overall, the proposed changes to Rule 5110 would simplify and clarify the application of Rule 5110 and align the rule with current practice relating to underwriting compensation. The additional flexibility in the proposed changes would facilitate negotiation between members and issuers of underwriting terms and arrangements that comply with Rule 5110. The proposed changes would also reduce the need for certain participating members to request exemptions from FINRA, reduce the amount of time for FINRA's review of these filings, allow issuers to access capital markets faster, and enhance the transparency and efficiency of the regulatory process. The codification of the exemptions as exclusions may lead some members that would not request an exemption under the baseline to use an exclusion, generating additional or greater investments in issuers thereby increasing access and options to capital raising.

The proposed amendments related to the valuation method for securities acquisitions would increase the options participating members have for receiving underwriting compensation, which may include convertible and non-convertible securities. Currently, participating members in these offerings experience challenges using the market price on the date of the acquisition because a "bona fide public market" does not exist. Because a value cannot be determined, participating members must either negotiate to be compensated in cash or request an exemption from FINRA because the receipt of such securities would constitute an unreasonable term or arrangement under Rule 5110(g)(1).

Under current Rule 5110, transactions involving capital investments made by affiliates of underwriters in DPPs and REITs as well as securities acquired by affiliates of underwriters in connection with debt-for-equity exchange transactions are deemed underwriting compensation. Hence, participating members must either find alternative financing options or request exemptive relief from the presumption that these transactions may be deemed underwriting compensation.

The proposed changes to codify these exemptions would reduce compliance costs for participating members insofar as they reduce the time and expense incurred by members' employees and outside legal counsel in seeking such exemptions. The proposed changes may also create new financing opportunities for issuers and members and reduce costs associated with such exemptions. The benefits may also extend to offerings exempt from the filing requirements in Rule 5110(h)(1), but otherwise subject to compliance.

Participating members that acquire non-convertible preferred securities in connection with a public offering at a fair price will benefit from the proposed amendments to treat non-convertible preferred securities equivalently to non-convertible or non-exchangeable debt securities. FINRA believes that these proposed changes would provide participating members additional flexibility and clarity with respect to the applicable requirements for such securities acquisitions under Rule 5110.

Anticipated Costs of Proposed Amendments to Rule 5110

As discussed earlier, the proposed amendments would codify prior positions taken by FINRA staff that have not imposed costs on issuers and investors. To the extent that codification allows for greater use of the flexibilities provided, capital formation may be enhanced at limited additional risk to investors. FINRA does not expect this change to affect overall underwriting compensation or negatively affect investors, given FINRA's oversight and competitive pressure among underwriters. Therefore, the proposed changes are not expected to increase costs to issuers and investors that participate and invest in public offerings.

Anticipated Benefits and Costs of Proposed Amendments to Rule 5123

The proposed changes would expand the scope of private placements that are exempt from the requirement of Rule 5123. The proposed exemptions relate to private placements sold to two additional types of institutional entities that were included in the SEC's amended definition of accredited investor in 2020 (i.e., certain entities owning investment in excess of $5,000,000 and certain family offices with assets under management in excess of $5,000,000).[28] Members in these offerings would no longer

[28] See supra note 5.

incur the costs to comply with Rule 5123, whereas the regulatory protection provided through the filings requirement is not necessary because the two new categories of accredited investors are considered to have sufficient sophistication to appropriately evaluate the risks and rewards of the investment and therefore warrant an exemption from Rule 5123.

The extent of the cost savings for members cannot be estimated in aggregate because FINRA does not collect the information that would identify the private placement offerings sold exclusively to the above two types of specified institutional entities. The expected cost savings would likely be greater for members that participate in these offerings more frequently or members that seek to expand their private placement activities.

Alternatives Considered

FINRA considered several alternatives in developing the proposed rule change. One alternative FINRA considered was to expand the types of securities that are eligible to be valued under the proposed rule to also include over-the-counter ("OTC") equity securities. While this alternative would provide participating members with additional compensation options, FINRA notes that there can be material differences in the frequency and volume of trading among OTC equity securities, which may impact the availability of information for use in performing valuations for such securities.

Although FINRA has not incorporated this alternative into the current proposed rule change, FINRA is continuing to evaluate whether additional types of securities could be eligible for valuation under Rule 5110. In the interim, FINRA believes the proposed rule change as drafted achieves an appropriate balance between supporting capital

formation and maintaining adequate issuer and investor protection. Under current Rule 5110, securities that trade only OTC in the U.S., including securities of foreign issuers, may nonetheless qualify as underwriting compensation. Further, foreign ordinary shares, including those traded OTC in the U.S., may be eligible for the designated offshore securities market provision proposed in this rule, and thus such securities would be eligible to be valued under the current proposal.[29]

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

In December 2024, FINRA published Regulatory Notice 24-17 (the "Notice"), requesting comment on the proposed rule change (the "Notice Proposal"). Six comments were received in response to the Notice. A copy of the Notice is attached as Exhibit 2a. A list of the commenters in response to the Notice is attached as Exhibit 2b, and copies of the comment letters received in response to the Notice are attached as Exhibit 2c.[30]

Most commenters were overall supportive of the direction of the proposed rule changes in the Notice, but not all commenters supported every aspect of the Notice Proposal. Some commenters sought clarifications or changes to specific rule provisions. FINRA has considered the concerns raised by commenters and, as discussed in detail

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29 FINRA estimates that, from February 1, 2025 to July 29, 2025, 9,435 out of 18,927 issuers with securities traded on the U.S. OTC market also have equity securities traded in foreign markets. These issuers account for most of total OTC market capitalization, with the dollar trade volume representing 89% of the total U.S. OTC equity market during the referenced six months period. The estimation is based on the American Depository Receipts, Global Depository Receipts, and foreign ordinary shares classification and market capitalization data for issuers for which this data is available.

30 All references to commenters are to the comment letters as listed in Exhibit 2b. See Exhibit 2b for a list of abbreviations assigned to commenters.

below, has addressed many of the concerns noted by commenters in response to the Notice Proposal. The comments and FINRA's responses are set forth in detail below.

Valuation Method under Rule 5110(c)

While the ABA expressed broad support for FINRA's efforts to continue to modernize its rules, simplify compliance and codify additional exclusions from underwriting compensation, the ABA expressed concern about the drafting of proposed FINRA Rule 5110(c) in the Notice Proposal. According to the ABA, because FINRA proposed to delete the words "or to a security with a bona fide public market" without substituting alternative language referring to "a security traded on a U.S. exchange or designated offshore market," the new valuation methods in paragraphs (c)(2)(A) and (c)(3)(B) for securities traded on U.S. exchanges and offshore markets "will be without effect."[31]

In response to the comments, FINRA has modified the proposed rule language to clarify that a security can be accurately valued "using any method in this paragraph (c)." This includes the valuation of a security traded on a national securities exchange that is registered under Section 6(a) of the Exchange Act or a designated offshore securities market as defined under Securities Act Rule 902(b). If the security can be accurately valued, it would not be subject to the prohibition in paragraph (g)(1), which precludes receipt of any underwriting compensation for which a value cannot be determined.

The ABA also suggested that FINRA expand the types of securities that are eligible to be valued under the rule to also include certain OTC equity securities, which are not traded on national securities exchanges. While FINRA has not incorporated this

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31 See ABA letter.

suggestion into the current proposed rule change, FINRA is continuing to evaluate whether additional types of securities could be eligible for valuation under Rule 5110.

Debt-for-Equity Exchanges

In general, FINRA received positive feedback and support for these proposed changes.[32] The ABA sought clarification that an affiliated member would not be prohibited from placing a portion of the equity securities acquired by the lender in its investment account if it is unable to sell that portion in the offering. In FINRA's view, the rule language in the Notice Proposal does not foreclose placing a portion of the equity securities acquired by the lender in its investment account if it is unable to sell that portion in the offering.

SIFMA sought clarification that the safe harbor would apply when the transaction is structured to provide economic and tax benefits to a direct or indirect shareholder of issuer. In FINRA's view, the definition of "issuer" is broad enough to capture significant shareholders.[33]

Capital Investments for DPPs and REITs

In general, FINRA received positive feedback and support for these proposed changes.[34] The ABA sought more guidance as to application of the exclusion in the Notice Proposal. The ABA, ADISA, and IPA also raised questions about whether the investments must be made before an offering, as the use of the word "seed" may imply before the offering. FINRA did not intend to limit the capital investments to before the

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32 See ABA, SIFMA letters.

33 See Rule 5110(j)(12).

34 See ABA, ADISA, IPA letters.

offering in the Notice Proposal. Accordingly, FINRA has replaced references to "seed capital" with "capital investments" and confirms that the amendments are agnostic to the timing of the acquisition.

IPA suggested that the principles-based approach FINRA proposed in the Notice should instead be a self-operating exclusion to provide regulatory certainty. FINRA agrees that the exclusion for capital investments would operate most efficiently as a self-operating exclusion instead of a principles-based approach and has replaced Supplementary Material .05 with new Supplementary Material .01(b)(24) to include these capital investments as an example of payments not deemed to be underwriting compensation.

ADISA recommended that the conditions in the proposed capital investments exclusion to underwriting compensation in the Notice Proposal should fully align with the North American Securities Administrators Association (NASAA) REIT Guidelines. According to ADISA, the proposed conditions for this exclusion do not provide that securities may be transferred to an affiliate of the sponsor, which is allowable pursuant to Section II.A.2. of the NASAA REIT Guidelines. ADISA suggested adding language to the rule text that "the securities acquired and excluded may be transferred to other affiliated entities, which transfer would not be deemed to constitute an economic disposition of the securities during the 180 day period."[35] In FINRA's view, this additional language is unnecessary, as the capital provided and transferred would already be excluded under FINRA Rule 5110(e)(2)(b), which permits the transfer of any security to any member participating in the offering and its officers or partners, its registered

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35 See ADISA letter.

persons or affiliates, if all transferred securities remain subject to the lock-up restriction in paragraph (e)(1) for the remainder of the 180-day lock-up period.[36]

ADISA also recommended that for the purposes of calculating the lockup restriction period in the Notice Proposal, FINRA should use the definitive date of effectiveness of the offering as a measurement rather than commencement of sales. In FINRA's view, replacing the date of commencement of sales with the date of effectiveness could result in an unreasonably short lockup period, as a prospectus may become effective long before the commencement of sales. Accordingly, FINRA did not accept this suggestion.

IPA suggested that FINRA clarify that a capitalization transaction occurring before the issuer has material assets will be deemed to occur at or above NAV, as a NAV determination should not be necessary in connection with a capital transaction.[37] FINRA agrees that a capitalization transaction occurring before the issuer has material assets would be deemed to occur at or above NAV.

Non-Convertible Preferred Securities

The ABA was generally supportive of treating non-convertible or non-exchangeable preferred securities the same as non-convertible or non-exchangeable debt or derivative instruments.[38] However, the ABA sought clarification that reliance on this exclusion in the Notice Proposal would not be prohibited where the otherwise non-convertible preferred securities convert into the class of securities to be sold to the public

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36 See Rule 5110(e)(2)(b).

37 See IPA letter.

38 See ABA letter.

as part of a recapitalization or other reorganization in preparation for an IPO. FINRA views this comment as beyond the scope of the proposed rule change.

Changes to Improve Operation of the Rule

The ABA was generally supportive of this proposed change, however the ABA suggested further clarification in the rule text defining "tail fee."[39] FINRA does not think it is necessary to define "tail fee," as "tail fee" is a commonly understood term and FINRA does not define other fees under the rule (e.g., termination fees, rights of first refusal). As FINRA stated in the Notice Proposal, tail fees provide compensation in the event of a subsequent financing from investors introduced by a member, following the termination of an agreement. Moreover, FINRA would review these fees based on the facts and circumstances of how they are structured.

Rule 5123

Several commenters, including SIFMA and ADISA, supported the Rule 5123 amendments in the Notice Proposal. However, Intellivest suggested that FINRA include all accredited investors under Rule 5123's filing exemption.[40] FINRA notes that the overwhelming majority of private placements are sold to accredited investors only. During 2022-2024, less than 4% of the private placements filed under Rule 5123 permitted sales to non-accredited investors. FINRA does not believe exempting review and oversight of the vast majority of private placements, including those that are offered and sold to all accredited investors, would be appropriate. First, retail accredited investors generally do not have the same level of sophistication and expertise as

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39 See supra note 38.

40 See Intellivest letter.

institutional accredited investors. Second, exempting review and oversight of the vast majority of private placements could impede FINRA's ability to detect misconduct in the private placement market, increasing risk exposure to retail investors. Third, FINRA notes that there are proposals in Congress and the SEC regarding the definition of accredited investor that we will monitor and consider in relation to Rule 5123 as they develop.

Intellivest also suggested that FINRA provide a safe harbor for a member that has a written agreement with another member to submit on its behalf the required 5123 filing, so a member would not need to follow up to ensure the other firm has met its filing obligations. FINRA views this comment as beyond the scope of the proposed rule change.

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.[41]

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.

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41 15 U.S.C. 78s(b)(2).

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 2a. Regulatory Notice 24-17 (December 2024).

Exhibit 2b. List of comments received in response to Regulatory Notice 24-17.

Exhibit 2c. Copies of comments received in response to Regulatory Notice 24-17.

Exhibit 5. Text of proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2026-002)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rules 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) and 5123 (Private Placements of Securities)

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 , the 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 Rules 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) and 5123 (Private Placements of Securities). The proposed amendments to Rule 5110 would improve and clarify the valuation method for securities considered underwriting compensation, add new exclusions from underwriting compensation that codify exemptions FINRA staff has issued, and include minor changes to improve the operation of the rule. The proposed amendments to Rule 5123 would expand available exemptions to include offerings sold to investors meeting

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

2 17 CFR 240.19b-4.

the categories of accredited investor for certain family offices and certain entities with assets under management in excess of $5,000,000, consistent with the Commission's treatment of those categories.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org and at the principal office of FINRA.

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

Background

The ability of small and large businesses to raise capital efficiently is critical to job creation and economic growth. Rule 5110 has played an important role in the capital raising process by prohibiting unfair underwriting terms and arrangements in connection with the public offering of securities. Moreover, Rule 5110 continues to be important to promoting investor protection and market integrity through effective and efficient regulation that facilitates vibrant capital markets.

Rule 5110 requires a member that participates in a public offering to file documents and information with FINRA about the underwriting terms and

arrangements.[3] FINRA's Corporate Financing Department ("Department") reviews this information prior to the commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of the applicable FINRA rules.[4]

The unregistered offering market also is an important source of capital for American businesses, including small and midsize companies. Rule 5123 plays a critical role in providing information that assists FINRA in the identification of potential trends and rule violations in the private placement market.

In general, Rule 5123 requires members to file with FINRA any private placement memorandum, term sheet or other offering document, and any retail communication that promotes or recommends a private placement, including any material amended versions thereof, used in connection with a private placement of securities within 15 calendar days of the date of first sale, unless the member can rely on an applicable exemption from the rule. Rule 5123 contains an exemption from filing for offerings sold to certain types of sophisticated institutional investors that qualify as

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[3] The following are examples of public offerings that are routinely filed: (1) initial public offerings ("IPOs"); (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs as defined in FINRA Rule 2310(a)(4) (Direct Participation Programs); (6) exchange offers; (7) offerings pursuant to SEC Regulation A; and (8) offerings by closed-end funds.

[4] FINRA does not approve or disapprove an offering; rather, the review relates solely to the FINRA rules governing underwriting terms and arrangements and does not purport to express any determination of compliance with any federal or state laws, or other regulatory or self-regulatory requirements regarding the offering. A member may proceed with a public offering only if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements. See Rule 5110(a)(1)(C)(ii).

"accredited investors" under Rule 501 of the Securities Act of 1933 ("Securities Act").[5] These institutional accredited investors have sufficient sophistication to warrant an exemption from the rule.

In 2020, the SEC amended the definition of accredited investor to include two additional types of institutional entities.[6] The amendments updated the definition of accredited investor to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in private capital markets.

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5 These "institutional" accredited investors are:

- banks and savings and loan associations; registered broker-dealers; investment advisers; insurance companies; investment companies; business development companies; Small Business Investment Companies; Rural Business Investment Companies; state employee benefit plans with assets in excess of $5 million; or ERISA employee benefit plans, if the investment decision is made by a plan fiduciary, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5 million, or if a self-directed plan, with investment decisions made solely by persons that are accredited investors (see Rule 501(a)(1));
- private business development companies (see Rule 501(a)(2));
- organizations described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million (see Rule 501(a)(3)); and
- trusts with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) (see Rule 501(a)(7)).

6 See Accredited Investor Definition, Securities Exchange Act Release 89669 (August 26, 2020), 85 FR 64234 (October 9, 2020), including new categories of accredited investor under Rule 501(a)(9) and (a)(12).

Overview of Proposed Amendments

The proposed amendments to Rule 5110 would improve and clarify parts of the rule covering the valuation method for securities deemed underwriting compensation. The proposed amendments would also include new exclusions from underwriting compensation that codify exemptions FINRA staff has issued and clarifications of other provisions, all of which would further promote capital formation without lessening investor or issuer protection. In addition, the proposed amendments would include several minor changes to improve the operation of the rule and address common questions encountered during the review process.

The proposed amendments to Rule 5123 would add two types of entities that would qualify under the existing filing exemption under Rule 5123, consistent with the Commission's treatment of the accredited investor definition.

Rule 5110 Proposed Amendments

Valuation Method for Securities Acquisitions Considered Underwriting Compensation

Currently, when participating members[7] acquire securities that are deemed underwriting compensation, the value of the securities is based on either the public offering price per security or the price paid per security on the date of acquisition if a "bona fide public market" exists for the security.[8] The definition of "bona fide public market" requires that the securities be traded on a national

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7 The term "participating member" means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer. See Rule 5110(j)(15).

8 See Rule 5110(c).

securities exchange and relies on SEC Regulation M's definitions of average daily trading volume and public float.[9] FINRA understands that members have experienced challenges determining whether a security had a "bona fide public market" on the acquisition date using this complex, multipart definition. When a security does not meet the definition, and does not have a public offering price, it cannot be valued under the rule and is therefore considered indeterminate compensation, which is prohibited under Rule 5110(g)(1).

The proposed rule change would amend Rule 5110(c)(2) and (3) by replacing "bona fide public market" with a valuation method in which the calculation is more predictable, based on the closing market price of a security traded on a registered national securities exchange or a "designated offshore securities market"[10] on the date of acquisition. Using this readily available market data would greatly simplify application of the rule.

Exclusions from Underwriting Compensation for Certain Securities Acquisitions

The proposed rule change is intended to foster capital raising by providing additional exclusions from underwriting compensation for certain types of investments by participating members in anticipation of, or concurrently with, a public offering. These proposed amendments cover (1) debt-for-equity exchanges; (2) capital investments for direct participation programs ("DPPs")[11]

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9 See Rule 5121(f)(3).

10 See Securities Act Rule 902(b).

11 See Rule 2310(a)(4).

and unlisted real estate investment trusts ("REITs");[12] and (3) non-convertible preferred securities, and describe factors FINRA has considered regarding whether to exclude securities acquisitions from being deemed underwriting compensation when such acquisitions are in connection with bona fide financing that would benefit the issuer and investors. Each proposed amendment is discussed below.

Debt-for-Equity Exchanges

Rule 5110 does not now provide an exclusion from underwriting compensation for securities acquired by affiliates of underwriters in connection with debt-for-equity exchange transactions. Debt-for-equity exchanges have increasingly occurred in recent years and provide favorable tax treatment and economic benefits to issuers.[13] A debt-for-equity exchange is composed of a series of transactions in which a lender acquires equity securities of the issuer, often referred to as exchange shares, in return for a cash loan. The exchange shares are subsequently or concurrently registered and offered by underwriters in a public offering. The offering proceeds are used, in whole or part, as repayment of the loan. When the lender is an affiliate of an underwriter, it falls within the definition of participating member, and the equity securities acquired by the affiliated lender for making the loan fall within the definition of underwriting compensation.

The proposed rule change would add new Supplementary Material .01(b)(23) to provide relief from such exchanges being deemed underwriting compensation if the

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12 See Rule 2231(d)(4).

13 Pursuant to Rule 5110(i), FINRA received 15 exemption requests for debt-for-equity transactions from 2022 through 2024.

equity acquired is part of a transaction that provides economic and tax benefits to the issuer and meets the following conditions:

- the affiliated member subsequently offered all of the equity securities the lender acquired in a firm commitment offering following the debt exchange;[14]
- the parties determined the terms of the debt exchange and the subsequent equity issued through arms' length negotiations based on the market price of the equity;[15] and
- the affiliated member negotiated customary compensation for the subsequent equity offering.

The proposed rule change would facilitate capital formation by providing consistent regulatory treatment of a common financing strategy issuers employ.

Capital Investments for DPPs and REITs

Rule 5110 does not now provide an exclusion from underwriting compensation for capital investments in exchange for an equity stake made by affiliates of underwriters concurrently with or in advance of a public offering. Such investments are common in DPP and REIT offerings to provide the initial or subsequent equity capital or financing needed by an issuer.

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14 Typically, lenders and affiliated members coordinate to satisfy this condition. However, even if they do not coordinate, the affiliated member can satisfy the condition with the subsequent offering.

15 Past exemptions that have been granted consistent with the conditions of this proposed Supplementary Material involved operating companies with equity listed on a national securities exchange with a market price and did not involve an IPO or a spinoff. Member firms intending to participate in transactions that do not align with the terms of this Supplementary Material may, as with any transaction subject to Rule 5110, request exemptive relief pursuant to FINRA Rule 5110(i) and the Rule 9600 Series.

The proposed rule change would add new Supplementary Material .01(b)(24) to provide relief from such transactions by setting out the conditions for excluding capital investments from being deemed underwriting compensation. Supplementary Material .01(b)(24) would work as a self-operating exclusion and would not limit when the transactions could occur. The conditions for Supplementary Material .01(b)(24) apply to securities acquired before or during the distribution of an offering by a participating member in the issuer or an affiliated entity and would require that:

- the capital investments are disclosed in the prospectus;
- the offering and the securities acquired in the capitalization transaction are valued and priced based on net asset value ("NAV");[16]
- the offering is subject to the requirements of Rule 2310 (Direct Participation Programs); and
- the securities acquired are restricted for a period of 180 days following the commencement of sales.

These conditions are intended to promote transparency, ensure fair valuation, and address potential conflicts of interest in these transactions.

Non-Convertible Preferred Securities

Rule 5110 provides that non-convertible or non-exchangeable debt securities and derivative instruments acquired by any participating member in a transaction related to a public offering at a fair price[17] are considered underwriting compensation but have no

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16 Capitalization transactions occurring before the issuer has material assets would be deemed to occur at or above NAV.

17 See Rule 5110.06(b).

compensation value.[18] Because both non-convertible debt and non-convertible preferred securities cannot be converted to common stock and provide predetermined payments to holders, resulting in fixed sources of income, FINRA views them as equivalent for purposes of the Rule 5110 exclusion and, accordingly, the proposed rule change would treat them in a comparable manner as long as non-convertible preferred securities are acquired at a fair price. This rule change would facilitate capital formation by providing members with predictable regulatory treatment and benefit issuers through the capital investments made in exchange for non-convertible preferred securities from affiliates of members that participate in public offerings.

Changes to Improve Operation of Rule 5110

The proposed rule change would make other minor modifications to Rule 5110 based on FINRA's experience reviewing filings that FINRA believes would improve the operation of the rule and reduce the number of questions raised by filers during the review process. For example, Rule 5110(g)(5)(B) permits termination fees or the receipt of compensation in the form of rights of first refusal in connection with a public offering that is terminated when specific requirements are met that protect the issuer (i.e., they are not deemed to be prohibited unreasonable terms or arrangements). Increasingly, members negotiate payments often described as "tail fees" in engagement letters that are

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[18] See Rules 5110(c)(5) and 5110.06. As a general rule, compensation that cannot be valued is prohibited. See Rule 5110(g)(1). Under this exclusion, treating these transactions as compensation without value permits the participating member to receive the securities (as long as they are received at a fair price) while still allowing FINRA the ability to review the transactions to determine whether they were, indeed, received at a fair price. If they were not, the value of underwriting compensation that is attributed to these securities is the difference between their fair price and their actual price.

similar to the terms and requirements for termination fees or rights of first refusal. Because tail fees provide compensation in the event of a subsequent financing from investors introduced by a member following the termination of an agreement, these payments are comparable to termination fees for purposes of Rule 5110. The proposed rule change would amend Rule 5110(g)(5)(B) to clarify that the same requirements would apply to such fees.[19] If these requirements are not met, tail fees would constitute unreasonable arrangements under Rule 5110.

Proposed Amendments to Rule 5123

The proposed rule change would add two types of entities to the filing exemption under Rule 5123, consistent with the Commission's treatment of the accredited investor definition. As stated above, in August 2020, the Commission adopted amendments to the definition of "accredited investor" under Rule 501[20] to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in private capital markets. These changes included:

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19 These requirements are that: (i) the agreement specifies that the issuer has a right of "termination for cause," which shall include the participating member's material failure to provide the underwriting services contemplated in the written agreement; (ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee or provision of any right of first refusal; (iii) the amount of any termination fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and (iv) the issuer shall not be responsible for paying the termination fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer. See Rule 5110(g)(5)(B).

20 See SEC Accredited Investor Definition Release, supra note 6.

- any entity, of a type not listed in paragraphs (a)(1), (2), (3), (7), or (8) of Rule 501, not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;[21] and
- any "family office" with assets under management in excess of $5,000,000, that is not formed for the specific purpose of acquiring the securities offered and its prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.[22]

Adding these two types of entities to the existing exemption would establish consistency with the purpose of Rule 5123. FINRA believes that the investors described above possess a level of sophistication and expertise that is similar to the institutional accredited investors currently exempted under Rule 5123 and generally do not need the additional protections and oversight provided through the filing requirements. FINRA notes that qualified purchasers, which currently are covered in another exemption from Rule 5123's filing requirements, are defined under the Investment Company Act of 1940 and the rules thereunder ("Investment Company Act") to include natural persons or certain companies that own not less than $5,000,000 in investments.[23] The two entities above have a similar financial threshold, which indicates an equivalently high level of sophistication to justify exemption from Rule 5123.[24]

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21 See 17 CFR 230.501(a)(9).

22 See 17 CFR 230.501(a)(12).

23 See Investment Company Act Section 2(a)(51).

24 The Commission's August 2020 accredited investor amendments promulgated additional categories of accredited investors, including natural persons holding

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.

2. Statutory Basis

FINRA believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(6) of the Act,[25] which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The proposed amendments to Rules 5110 would enhance the efficiency of FINRA rules and further support capital formation. For example, the proposed amendments to Rule 5110 would improve and clarify the application of Rule 5110 and align the rule with current practices relating to underwriting compensation. The proposed amendments to Rule 5110 regarding valuation of securities that are considered underwriting compensation would replace a valuation process that members have stated is unnecessarily complex and cumbersome with a simpler, more straightforward valuation process, which would provide predictability and efficiency to members' valuation processes. The proposed amendments to Rule 5110 regarding new exclusions from underwriting compensation that codify exemptions FINRA staff has issued would provide additional flexibility and clarity for member firms that would reduce the need for and cost associated with certain participating members requesting exemptions from

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professional certifications and designations or other credentials, knowledgeable employees of private funds, and certain family clients, which FINRA is not proposing to add in these amendments.

25 15 U.S.C. 78o-3(b)(6).

FINRA, reduce the amount of time for FINRA's review of these filings, allow issuers to access capital markets faster, and enhance the transparency and efficiency of the regulatory process.[26] The codification of these exemptions as exclusions may lead some members that would not request an exemption under the baseline to use an exclusion, generating additional or greater investments in issuers, thereby increasing access and options to capital raising.

The proposed amendments to Rule 5110 also would maintain important protections for issuers and investors participating in offerings. The proposed valuation method would continue to ensure that securities that are acquired by underwriters are valued fairly. In addition, the proposed exclusions are narrowly tailored and based on exemptive relief FINRA has provided, which have worked well for issuers and investors.[27] The proposed rule change also would not decrease FINRA's ability to oversee underwriting terms and arrangements. In totality, the proposed rule change would reduce the administrative and operational burdens for members and FINRA, promote regulatory efficiency, and enhance market functioning while maintaining issuer and investor protection.

The proposed amendments to Rules 5123 also would enhance the efficiency of FINRA rules and further support capital formation. By expanding the scope of private

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25 FINRA received 21 requests for exemptions for capital investments and debt-for-equity transactions from 2022 through 2024. Each request required substantial analysis by FINRA staff and discussions with the member firm, resulting in a longer review of a potential offering in order to consider the request.

27 Rule 5110.01(b)(23) – (24) codifies the factors and factual circumstances FINRA has consistently considered when granting these exemptions.

placements that are exempt from the requirement of Rule 5123, members that participate in these offerings would no longer be required to comply with Rule 5123.

In addition, the proposed amendments to Rule 5123 would not diminish investor protection. The institutional investors who would be covered by the filing exemption possess a level of sophistication and expertise that is similar to the institutional accredited investors currently exempted under Rule 5123 and generally do not need the additional protections and oversight provided through the filing requirements. Non-institutional accredited investors who may not possess the same level of sophistication and expertise as institutional investors would continue to receive the protections of the Rule 5123 filing requirement, with FINRA reviewing private placement offerings sold to these investors and helping detect misconduct in the private placement process, thereby promoting investor protection.

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

FINRA does not believe that the proposed rule changes 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 to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet FINRA's regulatory objectives.

Regulatory Need

As discussed earlier, the current approach to valuation of securities that are considered underwriting compensation under current Rule 5110 can be complex, creating unnecessary burdens for members and uncertainty on whether they are permitted to acquire certain securities or required to receive a different form of compensation. The proposed rule change would provide a simpler, more straightforward approach. In addition, certain transactions require participating members to request exemptions from FINRA. This approval process can increase the amount of time for issuers to access capital markets. By codifying existing FINRA staff positions, the proposed rule change would reduce such requests by replacing existing requirements with more practical and transparent alternatives. The proposed rule change would also expand the exemptions available in Rule 5123 and better align FINRA rules with SEC rules relating to the treatment of institutional accredited investors.

Economic Baseline

The economic baseline for the proposed rule changes is the existing regulation framework of public offerings and private placements subject to regulatory oversight under Rules 5110 and 5123 and their interpretations and implementation by FINRA. The economic baseline also includes industry practices relating to and compliance with these existing regulations and other relevant regulatory frameworks.

With respect to public offerings subject to Rules 5110, FINRA evaluated filing information to assess members' participation in public offerings required to be filed with FINRA. FINRA notes that the observations addressed here do not include observations in which members may have relied on a filing exemption under Rule 5110(h)(1). FINRA

received 3,711 new filings under Rule 5110 during 2022-2024. The annual number of new filings ranged from 1,398 in 2022 to 1,209 in 2024, with an average number of 1,237 filings per year. These filings represented underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering conducted by 333 members, to the extent the member's participation in the public offering is required to be provided. The average and median number of filings in which a member participated was 15 and three during the period, respectively. The aggregate amount of offering proceeds in association with these filings was over $781 billion, with a median value of approximately $50 million per filing.

Certain proposed changes to Rule 5110 specifically relate to public offerings with capital investments for DPPs and REITs, debt-for-equity transactions, and securities acquired by a participating member without a "bona fide public market." FINRA collected information on exemption requests submitted by members in non-shelf filings related to these three sets of acquisitions. An analysis of this data finds that among the 2,402 new non-shelf offerings filed under Rule 5110 during 2022-2024, six (0.25 percent) offerings requested exemptions relating to capital investments for DPPs and REITs, 15 (0.62 percent) offerings requested exemptions relating to debt-for-equity transactions, and 12 (0.5 percent) offerings requested exemptions relating to valuing securities without a bona fide public market.[28] A majority of these exemptions were granted after FINRA took into consideration all relevant factors.

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[28] See Rule 5110(i). "Pursuant to the Rule 9600 Series, FINRA, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest."

With respect to private placement offerings under Rule 5123, FINRA collected information detailing 8,485 unique filings under Rule 5123 submitted by 525 members during the above period. The annual number of unique filings ranged from 3,807 in 2022 to 2,344 in 2024, with an average number of 2,828 filings per year. Among the 8,485 unique filings, 7,599 (90 percent) had projected proceeds totaling $388 billion with a median value of $10 million per filing. Projected proceeds were reported as unknown for the remaining filings. The average and median number of these filings submitted per participating member during the above period were 15 and three, respectively.

Economic Impact

The proposed rule change would directly impact members, issuers and investors that participate in public offerings and private placements. This economic impact analysis considers the significant impacts associated with specific rule changes relating to underwriting compensation and private placement offerings.

Anticipated Benefits of Proposed Amendments to Rule 5110

Overall, the proposed changes to Rule 5110 would simplify and clarify the application of Rule 5110 and align the rule with current practice relating to underwriting compensation. The additional flexibility in the proposed changes would facilitate negotiation between members and issuers of underwriting terms and arrangements that comply with Rule 5110. The proposed changes would also reduce the need for certain participating members to request exemptions from FINRA, reduce the amount of time for FINRA's review of these filings, allow issuers to access capital markets faster, and enhance the transparency and efficiency of the regulatory process. The codification of the exemptions as exclusions may lead some members that would not request an

exemption under the baseline to use an exclusion, generating additional or greater investments in issuers thereby increasing access and options to capital raising.

The proposed amendments related to the valuation method for securities acquisitions would increase the options participating members have for receiving underwriting compensation, which may include convertible and non-convertible securities. Currently, participating members in these offerings experience challenges using the market price on the date of the acquisition because a "bona fide public market" does not exist. Because a value cannot be determined, participating members must either negotiate to be compensated in cash or request an exemption from FINRA because the receipt of such securities would constitute an unreasonable term or arrangement under Rule 5110(g)(1).

Under current Rule 5110, transactions involving capital investments made by affiliates of underwriters in DPPs and REITs as well as securities acquired by affiliates of underwriters in connection with debt-for-equity exchange transactions are deemed underwriting compensation. Hence, participating members must either find alternative financing options or request exemptive relief from the presumption that these transactions may be deemed underwriting compensation.

The proposed changes to codify these exemptions would reduce compliance costs for participating members insofar as they reduce the time and expense incurred by members' employees and outside legal counsel in seeking such exemptions. The proposed changes may also create new financing opportunities for issuers and members and reduce costs associated with such exemptions. The benefits may also extend to

offerings exempt from the filing requirements in Rule 5110(h)(1), but otherwise subject to compliance.

Participating members that acquire non-convertible preferred securities in connection with a public offering at a fair price will benefit from the proposed amendments to treat non-convertible preferred securities equivalently to non-convertible or non-exchangeable debt securities. FINRA believes that these proposed changes would provide participating members additional flexibility and clarity with respect to the applicable requirements for such securities acquisitions under Rule 5110.

Anticipated Costs of Proposed Amendments to Rule 5110

As discussed earlier, the proposed amendments would codify prior positions taken by FINRA staff that have not imposed costs on issuers and investors. To the extent that codification allows for greater use of the flexibilities provided, capital formation may be enhanced at limited additional risk to investors. FINRA does not expect this change to affect overall underwriting compensation or negatively affect investors, given FINRA's oversight and competitive pressure among underwriters. Therefore, the proposed changes are not expected to increase costs to issuers and investors that participate and invest in public offerings.

Anticipated Benefits and Costs of Proposed Amendments to Rule 5123

The proposed changes would expand the scope of private placements that are exempt from the requirement of Rule 5123. The proposed exemptions relate to private placements sold to two additional types of institutional entities that were included in the SEC's amended definition of accredited investor in 2020 (i.e., certain entities owning investment in excess of $5,000,000 and certain family offices with assets under

management in excess of $5,000,000).[29] Members in these offerings would no longer incur the costs to comply with Rule 5123, whereas the regulatory protection provided through the filings requirement is not necessary because the two new categories of accredited investors are considered to have sufficient sophistication to appropriately evaluate the risks and rewards of the investment and therefore warrant an exemption from Rule 5123.

The extent of the cost savings for members cannot be estimated in aggregate because FINRA does not collect the information that would identify the private placement offerings sold exclusively to the above two types of specified institutional entities. The expected cost savings would likely be greater for members that participate in these offerings more frequently or members that seek to expand their private placement activities.

Alternatives Considered

FINRA considered several alternatives in developing the proposed rule change. One alternative FINRA considered was to expand the types of securities that are eligible to be valued under the proposed rule to also include over-the-counter ("OTC") equity securities. While this alternative would provide participating members with additional compensation options, FINRA notes that there can be material differences in the frequency and volume of trading among OTC equity securities, which may impact the availability of information for use in performing valuations for such securities.

Although FINRA has not incorporated this alternative into the current proposed rule change, FINRA is continuing to evaluate whether additional types of securities could

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29 See supra note 6.

be eligible for valuation under Rule 5110. In the interim, FINRA believes the proposed rule change as drafted achieves an appropriate balance between supporting capital formation and maintaining adequate issuer and investor protection. Under current Rule 5110, securities that trade only OTC in the U.S., including securities of foreign issuers, may nonetheless qualify as underwriting compensation. Further, foreign ordinary shares, including those traded OTC in the U.S., may be eligible for the designated offshore securities market provision proposed in this rule, and thus such securities would be eligible to be valued under the current proposal.[30]

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

In December 2024, FINRA published Regulatory Notice 24-17 (the "Notice"), requesting comment on the proposed rule change (the "Notice Proposal"). Six comments were received in response to the Notice. A copy of the Notice is available on FINRA's website at http://www.finra.org. A list of the commenters in response to the Notice and copies of the comment letters received in response to the Notice are available on FINRA's website.[31]

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30 FINRA estimates that, from February 1, 2025 to July 29, 2025, 9,435 out of 18,927 issuers with securities traded on the U.S. OTC market also have equity securities traded in foreign markets. These issuers account for most of total OTC market capitalization, with the dollar trade volume representing 89% of the total U.S. OTC equity market during the referenced six months period. The estimation is based on the American Depository Receipts, Global Depository Receipts, and foreign ordinary shares classification and market capitalization data for issuers for which this data is available.

31 See SR-FINRA-2026-002 (Form 19b-4, Exhibits 2b and 2c) for a list of abbreviations assigned to commenters (available on FINRA's website at http://www.finra.org).

Most commenters were overall supportive of the direction of the proposed rule changes in the Notice, but not all commenters supported every aspect of the Notice Proposal. Some commenters sought clarifications or changes to specific rule provisions. FINRA has considered the concerns raised by commenters and, as discussed in detail below, has addressed many of the concerns noted by commenters in response to the Notice Proposal. The comments and FINRA's responses are set forth in detail below.

Valuation Method under Rule 5110(c)

While the ABA expressed broad support for FINRA's efforts to continue to modernize its rules, simplify compliance and codify additional exclusions from underwriting compensation, the ABA expressed concern about the drafting of proposed FINRA Rule 5110(c) in the Notice Proposal. According to the ABA, because FINRA proposed to delete the words "or to a security with a bona fide public market" without substituting alternative language referring to "a security traded on a U.S. exchange or designated offshore market," the new valuation methods in paragraphs (c)(2)(A) and (c)(3)(B) for securities traded on U.S. exchanges and offshore markets "will be without effect."[32]

In response to the comments, FINRA has modified the proposed rule language to clarify that a security can be accurately valued "using any method in this paragraph (c)." This includes the valuation of a security traded on a national securities exchange that is registered under Section 6(a) of the Exchange Act or a designated offshore securities market as defined under Securities Act Rule 902(b). If the security can be accurately

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32 See ABA letter.

valued, it would not be subject to the prohibition in paragraph (g)(1), which precludes receipt of any underwriting compensation for which a value cannot be determined.

The ABA also suggested that FINRA expand the types of securities that are eligible to be valued under the rule to also include certain OTC equity securities, which are not traded on national securities exchanges. While FINRA has not incorporated this suggestion into the current proposed rule change, FINRA is continuing to evaluate whether additional types of securities could be eligible for valuation under Rule 5110.

Debt-for-Equity Exchanges

In general, FINRA received positive feedback and support for these proposed changes.[33] The ABA sought clarification that an affiliated member would not be prohibited from placing a portion of the equity securities acquired by the lender in its investment account if it is unable to sell that portion in the offering. In FINRA's view, the rule language in the Notice Proposal does not foreclose placing a portion of the equity securities acquired by the lender in its investment account if it is unable to sell that portion in the offering.

SIFMA sought clarification that the safe harbor would apply when the transaction is structured to provide economic and tax benefits to a direct or indirect shareholder of issuer. In FINRA's view, the definition of "issuer" is broad enough to capture significant shareholders.[34]

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33 See ABA, SIFMA letters.

34 See Rule 5110(j)(12).

Capital Investments for DPPs and REITs

In general, FINRA received positive feedback and support for these proposed changes.[35] The ABA sought more guidance as to application of the exclusion in the Notice Proposal. The ABA, ADISA, and IPA also raised questions about whether the investments must be made before an offering, as the use of the word "seed" may imply before the offering. FINRA did not intend to limit the capital investments to before the offering in the Notice Proposal. Accordingly, FINRA has replaced references to "seed capital" with "capital investments" and confirms that the amendments are agnostic to the timing of the acquisition.

IPA suggested that the principles-based approach FINRA proposed in the Notice should instead be a self-operating exclusion to provide regulatory certainty. FINRA agrees that the exclusion for capital investments would operate most efficiently as a self-operating exclusion instead of a principles-based approach and has replaced Supplementary Material .05 with new Supplementary Material .01(b)(24) to include these capital investments as an example of payments not deemed to be underwriting compensation.

ADISA recommended that the conditions in the proposed capital investments exclusion to underwriting compensation in the Notice Proposal should fully align with the North American Securities Administrators Association (NASAA) REIT Guidelines. According to ADISA, the proposed conditions for this exclusion do not provide that securities may be transferred to an affiliate of the sponsor, which is allowable pursuant to Section II.A.2. of the NASAA REIT Guidelines. ADISA suggested adding language to

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35 See ABA, ADISA, IPA letters.

the rule text that "the securities acquired and excluded may be transferred to other affiliated entities, which transfer would not be deemed to constitute an economic disposition of the securities during the 180 day period."[36] In FINRA's view, this additional language is unnecessary, as the capital provided and transferred would already be excluded under FINRA Rule 5110(e)(2)(b), which permits the transfer of any security to any member participating in the offering and its officers or partners, its registered persons or affiliates, if all transferred securities remain subject to the lock-up restriction in paragraph (e)(1) for the remainder of the 180-day lock-up period.[37]

ADISA also recommended that for the purposes of calculating the lockup restriction period in the Notice Proposal, FINRA should use the definitive date of effectiveness of the offering as a measurement rather than commencement of sales. In FINRA's view, replacing the date of commencement of sales with the date of effectiveness could result in an unreasonably short lockup period, as a prospectus may become effective long before the commencement of sales. Accordingly, FINRA did not accept this suggestion.

IPA suggested that FINRA clarify that a capitalization transaction occurring before the issuer has material assets will be deemed to occur at or above NAV, as a NAV determination should not be necessary in connection with a capital transaction.[38] FINRA agrees that a capitalization transaction occurring before the issuer has material assets would be deemed to occur at or above NAV.

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36 See ADISA letter.

37 See Rule 5110(e)(2)(b).

38 See IPA letter.

Non-Convertible Preferred Securities

The ABA was generally supportive of treating non-convertible or non-exchangeable preferred securities the same as non-convertible or non-exchangeable debt or derivative instruments.[39] However, the ABA sought clarification that reliance on this exclusion in the Notice Proposal would not be prohibited where the otherwise non-convertible preferred securities convert into the class of securities to be sold to the public as part of a recapitalization or other reorganization in preparation for an IPO. FINRA views this comment as beyond the scope of the proposed rule change.

Changes to Improve Operation of the Rule

The ABA was generally supportive of this proposed change, however the ABA suggested further clarification in the rule text defining "tail fee."[40] FINRA does not think it is necessary to define "tail fee," as "tail fee" is a commonly understood term and FINRA does not define other fees under the rule (e.g., termination fees, rights of first refusal). As FINRA stated in the Notice Proposal, tail fees provide compensation in the event of a subsequent financing from investors introduced by a member, following the termination of an agreement. Moreover, FINRA would review these fees based on the facts and circumstances of how they are structured.

Rule 5123

Several commenters, including SIFMA and ADISA, supported the Rule 5123 amendments in the Notice Proposal. However, Intellivest suggested that FINRA include

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39 See ABA letter.

40 See supra note 39.

all accredited investors under Rule 5123's filing exemption.[41] FINRA notes that the overwhelming majority of private placements are sold to accredited investors only. During 2022-2024, less than 4% of the private placements filed under Rule 5123 permitted sales to non-accredited investors. FINRA does not believe exempting review and oversight of the vast majority of private placements, including those that are offered and sold to all accredited investors, would be appropriate. First, retail accredited investors generally do not have the same level of sophistication and expertise as institutional accredited investors. Second, exempting review and oversight of the vast majority of private placements could impede FINRA's ability to detect misconduct in the private placement market, increasing risk exposure to retail investors. Third, FINRA notes that there are proposals in Congress and the SEC regarding the definition of accredited investor that we will monitor and consider in relation to Rule 5123 as they develop.

Intellivest also suggested that FINRA provide a safe harbor for a member that has a written agreement with another member to submit on its behalf the required 5123 filing, so a member would not need to follow up to ensure the other firm has met its filing obligations. FINRA views this comment as beyond the scope of the proposed rule change.

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

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41 See Intellivest letter.

if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

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

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

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-2026-002 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-2026-002. 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 filing will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable

information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to File Number SR-FINRA-2026-002 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.[42]

Jill M. Peterson
Assistant Secretary

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42 17 CFR 200.30-3(a)(12).

EXHIBIT 2a

Regulatory Notice 24-17

Capital Formation

FINRA Requests Comment on Proposed Changes to Corporate Financing Rules

Comment Period Expires: March 20, 2025

December 20, 2024

Notice Type
- Request for Comment

Suggested Routing
- Compliance
- Corporate Finance
- Institutional
- Investment Banking
- Legal
- Senior Management
- Syndicate
- Underwriting

Key Topic
- Capital Formation
- Conflicts of Interest
- Convertible Securities
- Corporate Financing
- Distribution of Securities
- Initial Public Offerings
- Investment Banking
- Private Placements
- Public Offerings
- Qualified Independent Underwriter
- Underwriting Compensation
- Unlisted REITs and DPPs
- Venture Capital

Referenced Rules & Notices
- Regulation D
- Regulation M
- Regulatory Notice 23-09
- Rules 5110, 5121, 2310 and 5123
- Securities Act Rule 501

Summary

FINRA seeks comment on proposed amendments to FINRA Rules 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements), 5121 (Public Offerings of Securities With Conflicts of Interest) and 5123 (Private Placements of Securities) to make substantive, organizational and terminology changes to the rules. The proposed amendments are in response to feedback FINRA received from *Regulatory Notice 23-09* requesting comments on rules, operations and administrative processes impacting capital formation.

The proposed rule text marked to show changes from the current rule text is available in Attachment A.

Questions concerning this *Notice* should be directed to:

- Gabriela Aguero, Vice President, Corporate Financing, by email or (240) 386-4657;
- Matthew Vitek, Associate General Counsel, Office of General Counsel, by email or (240) 386-6490; or
- Minwen Li, Senior Economist, Regulatory Economics and Market Analysis, by email or (202) 728-8009.

Action Requested

FINRA encourages all interested parties to comment. Comments must be received by March 20, 2025.

Comments must be submitted through one of the following methods:

- Online using FINRA's comment form for this *Notice*;
- Emailing comments; or
- Mailing comments in hard copy to:
  Jennifer Piorko Mitchell
  Office of the Corporate Secretary
  FINRA
  1700 K Street, NW
  Washington, DC 20006

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

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

Before becoming effective, the proposed rule change must be approved by the FINRA Board of Governors and filed with the Securities and Exchange Commission (SEC or Commission) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).[2]

Background & Discussion

In May 2023, FINRA published *Regulatory Notice 23-09* requesting comments on rules, operations and administrative processes impacting capital formation.[3] In response to feedback FINRA received from *Regulatory Notice 23-09*, FINRA is seeking comment on proposed amendments that would, among other things:

- improve and clarify parts of Rule 5110 regulating underwriting compensation, including the valuation method for and exceptions from securities acquisitions that are considered underwriting compensation;
- simplify compliance and improve the operation of Rule 5121 by clarifying the substantive requirements of a conflicted member and a Qualified Independent Underwriter (QIU); and
- expand the exemptions available in Rule 5123 to include offerings sold to investors meeting the categories of accredited investor for certain family offices and certain entities with assets under management in excess of $5 million, consistent with the SEC's treatment of those categories.[4]

Although not addressed further in this *Notice*, FINRA notes that, in addition to the proposed amendments described below, FINRA implemented operational improvements in response to comments from members that raise capital relying on Regulation A+ and other exempt offerings.[5]

Proposed Amendments to Rule 5110

Rule 5110 prohibits unfair underwriting arrangements in connection with the public offering of securities. The rule requires a member that participates in a public offering to file documents and information with FINRA about the underwriting terms and arrangements.[6] FINRA's Corporate Financing Department reviews this information prior to the commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of the applicable FINRA rules.[7]

The proposed amendments would improve and clarify parts of the rule covering the valuation method for securities deemed underwriting compensation. The proposed amendments would also include new exceptions from underwriting compensation that codify positions FINRA staff has taken and clarifications of other provisions, all of which will further promote capital formation without lessening investor protection. Further, the proposed amendments include several smaller changes that should improve the operation of the rule and reduce common questions encountered during the review process.

Valuation Method for Securities Acquisitions Considered Underwriting Compensation

When participating members[8] acquire securities that are deemed underwriting compensation, the value of the securities is determined by calculating the value based on the price paid per security on the date of acquisition if a "bona fide public market" exists for the security.[9] The definition of "bona fide public market" relies on SEC Regulation M's definitions of average daily trading volume and public float. Members experience challenges determining whether a security had a "bona fide public market" on the acquisition date using this multipart definition. When a security does not meet the definition, it cannot be valued under the rule and is therefore considered indeterminate compensation, which is prohibited under Rule 5110(g)(1). FINRA proposes to amend Rule 5110(c)(2) and (3) by replacing "bona fide public market" with a valuation method that is more predictable and is based on the closing market price of a security traded on a registered national securities exchange or a "designated offshore securities market"[10] on the date of acquisition. Using this readily available market data would greatly simplify application of Rule 5110.

Safe Harbors From Underwriting Compensation for Certain Securities Acquisitions

FINRA is proposing amendments intended to foster capital raising by providing additional "safe harbors" for certain types of investments by participating members in anticipation of, or concurrently with, a public offering. The proposed amendments describe factors FINRA has considered regarding whether to exclude securities acquisitions from being deemed underwriting compensation when such acquisitions are in connection with bona fide financing that would benefit the issuer and investors.

Seed Capital Investments for Unlisted Real Estate Investment Trusts (REITs) and Direct Participation Programs (DPPs)

Rule 5110 does not now provide an exception from underwriting compensation for seed capital investments affiliates of underwriters make concurrently with or in advance of a public offering. Such investments are common in unlisted REIT and DPP offerings to provide the initial equity capital or initial financing for an issuer (seed capital investments). FINRA is proposing to adopt a new principles-based approach in new Supplementary Material .05 (Seed Capital Investments) that sets out the conditions for excluding seed capital investments from being deemed underwriting compensation. The conditions would require that:

- the seed capital investments are disclosed in the prospectus;
- the offering and the acquisitions are valued and priced based on net asset value;
- the offering is subject to the requirements of Rule 2310 (Direct Participation Programs); and
- the securities acquired are restricted for a period of 180 days following the commencement of sales.

Debt-for-Equity Exchanges

Rule 5110 does not now provide an exception from underwriting compensation for securities affiliates of underwriters acquire in connection with debt-for-equity exchange transactions. Debt-for-equity exchanges have become prevalent in recent years and provide favorable tax treatment and economic benefits to issuers. A debt-for-equity exchange is composed of a series of transactions in which a lender acquires equity securities of the issuer, often referred to as exchange shares, in return for a cash loan. The exchange shares are subsequently or concurrently registered and offered by underwriters in a public offering. The offering proceeds are used, in whole or in part, as repayment of the loan. When the lender is an affiliate of an underwriter, it falls within the definition of participating member, and the equity securities acquired by the affiliated lender for making the loan fall within

the definition of underwriting compensation. Proposed new Supplementary Material .01(b)(23) would provide relief from such exchanges being deemed underwriting compensation if the equity acquired is part of a bona fide tax-favorable financing transaction and meets the following conditions:

- the affiliated member subsequently offered all of the equity securities the lender acquired in an offering following the debt exchange;
- the parties determined the terms of the debt exchange and the subsequent equity issued through arms' length negotiations based on the market price of the equity;
- the affiliated member negotiated customary compensation for an equity public offering; and
- the equity the affiliate received is offered in a firm commitment distribution.

The proposed amendment facilitates capital formation by providing predictable regulatory treatment of a common financing strategy issuers employ.

Non-Convertible Preferred Securities

Rule 5110 provides that non-convertible or non-exchangeable debt securities and derivative instruments acquired in a transaction related to a public offering at a fair price are considered underwriting compensation but have no compensation value.[11] This treatment does not now extend to non-convertible preferred securities. FINRA views such non-convertible preferred securities as equivalent to non-convertible debt securities for purposes of the Rule 5110 safe harbor and, accordingly, the proposal would treat them in a comparable manner. This amendment facilitates capital formation by providing members with predictable regulatory treatment and benefits the issuers with the capital investments made in exchange for non-convertible preferred securities from affiliates of members that participate in public offerings.

Operational Changes

The proposed amendments make other changes that would improve the operation of the rule and reduce the number of questions filers raise during the review process. These changes are based on staff's experience conducting filing reviews. For example, Rule 5110(g)(5)(B) permits termination fees and the receipt of compensation in the form of rights of first refusal in connection with a public offering that is not completed according to the terms of an agreement, provided specific requirements are met that protect the issuer (*i.e.*, they are not deemed to be prohibited unreasonable terms or arrangements). Members frequently negotiate "tail fees" in engagement letters that differ from the terms and requirements for

termination fees or rights of first refusal. Because tail fees provide compensation in the event of a subsequent financing from investors introduced by a member, following the termination of an agreement, these arrangements are comparable in nature to a termination fee. The proposal would amend Rule 5110(g)(5)(B) to clarify that the same requirements would apply to such fees. If those requirements are not met, the receipt of any tail fees in connection with a public offering would constitute an unreasonable term or arrangement under Rule 5110.

Proposed Amendments to Rule 5121

Rule 5121 applies to public offerings of securities in which a member or any of its associated persons or affiliates has a conflict of interest. If a member with a conflict of interest participates in a public offering, the rule requires "prominent disclosure" and, in certain circumstances, a QIU.[12] FINRA is proposing to modernize and clarify key provisions of Rule 5121, including the definition of "bona fide public market" and the meaning of "primarily responsible for managing the public offering" with respect to the requirements under Rule 5121. FINRA is also proposing amendments informed by its experience in exams and enforcement of the rule, including certain observations that emerged from FINRA's SPAC Sweep.[13] Overall, the amendments to Rule 5121 are intended to simplify compliance and improve the operation of the rule by clarifying the rule's requirements and making key requirements more explicit, all of which promote capital formation and strengthen investor protection.

"Bona Fide Public Market" Exception to the QIU Requirement

Under Rule 5121(a), if a member has a conflict of interest with respect to a public offering of securities, a QIU is required to conduct due diligence for the member to participate in the offering unless one of three conditions are met, one of which is a condition that the securities offered have a "bona fide public market." The current definition of "bona fide public market" is multifaceted, requiring members to determine an issuer's average daily trading volume (ADTV) and public float. That combination of conditions has created confusion and frequent interpretive questions regarding appropriate measurement periods, calculation methods and price points.

FINRA proposes to replace the "bona fide public market" condition with a standard that requires the issuer, as of the "required filing date,"[14] to have been a reporting company for at least one year, be current in its reporting requirements and have an aggregate market value of common equity of at least $300 million. Based on information currently available, FINRA anticipates that the $300 million limit would exclude approximately half of all exchange listed issuers but will ensure the company is followed to a meaningful degree by investors and the analyst community. Similarly, the reporting company requirement will help ensure sufficient public information is available to investors. The current "bona fide public market" condition also requires an issuer to be current in its reporting obligations, but requires just 90 days of

reporting history, along with a public float value of at least $150 million and an ADTV of at least $1 million. FINRA believes that an issuer's capital value and amount of public information available for investors are more appropriate measurements for purposes of the exception than a bona fide market test that focuses on liquidity and trading volume.

Obligations of a Conflicted Member and QIU

The proposal adds new requirements and guidance, and reorganizes the rule's existing obligations for ease of reference. For instance, proposed Rule 5121(a)(2) and (3) add that, when a QIU is required, the conflicted member and the QIU must enter into a written agreement that details the services the QIU will provide and reflects the QIU's compensation. Under proposed Rule 5121(a)(3), moreover, a QIU must confirm that it participated in the preparation of the registration statement and exercised the usual standards of due diligence. The proposal also includes guidance in Supplementary Material on the obligations of both conflicted members and QIUs (*e.g.*, on the need to provide a QIU with sufficient time to perform appropriate due diligence of an offering and a QIU's duties if retained after the initial filing of a registration statement). The proposal also reorganizes parts of Rule 5121's layout to make it easier to understand the interrelated obligations of both conflicted members and QIUs. The proposed amendments will aid and strengthen members' compliance, and our oversight of that compliance.

Additional Guidance to Participating Members

The proposal includes Supplementary Material that provides guidance to participating members concerning the requirements of Rule 5121.

Proposed Supplementary Material .01 (Lead Members) provides guidance on the responsibilities of: (1) a member primarily responsible for managing the public offering; (2) two or more members that are primarily responsible for managing the public offering; and (3) conflicted members in best efforts offerings when there is not a member primarily responsible for managing the offering. In addition, the proposed Supplementary Material provides guidance on when members participating in the offering may act as a QIU.

Proposed Supplementary Material .03 (Economic Interest in Offering Proceeds) provides a clarification regarding economic interests. Rule 5121 provides that there is a conflict of interest when at least five percent of the net offering proceeds, excluding underwriting compensation, are directed to a member, its affiliates and associated persons.[15] The proposed Supplementary Material provides that the conflict of interest only applies if the participating member and its related affiliates and associated persons have an economic interest in the proceeds but does not include proceeds held in brokerage accounts on behalf of a member's customer.

Proposed Amendments to Rule 5123

In general, Rule 5123 requires members to file with FINRA any private placement memorandum, term sheet or other offering document, and any retail communication that promotes or recommends a private placement, including any material amended versions thereof, used in connection with a private placement of securities within 15 calendar days of the date of first sale.

Rule 5123 contains an exemption from filing for offerings sold to certain types of sophisticated institutional investors that qualify as "accredited investors" under Securities Act Rule 501.[16] These institutional accredited investors have sufficient sophistication to warrant an exemption from the rule.

In August 2020, the SEC adopted amendments to the definition of "accredited investor" under Rule 501[17] to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in private capital markets and included:

- any entity, of a type not listed in paragraphs (a)(1), (2), (3), (7), or (8) of Rule 501, not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;[18] and
- any "family office" with assets under management in excess of $5,000,000, that is not formed for the specific purpose of acquiring the securities offered and its prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment.[19]

The investors described above under Rule 501(a)(9) and (12) possess a level of sophistication and expertise that is similar to the institutional accredited investors currently exempted under Rule 5123 and generally do not need the additional protections and oversight provided through the filing requirements. FINRA notes that qualified purchasers, which currently are covered in an exemption from Rule 5123's filing requirements, are defined under the Investment Company Act of 1940 (Investment Company Act) to include natural persons or companies that own not less than $5,000,000 in investments.[20] The two entities above have the same financial threshold, which indicates an equivalently high level of sophistication to justify exemption from Rule 5123.

The proposal amends Rule 5123 to expand its exemptions consistent with the SEC's treatment of the accredited investor definition. Adding these two types of entities to the existing exemption establishes consistency and is appropriate for the purpose of Rule 5123.

Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the economic baseline for the proposed amendments and their potentially significant economic impacts, including anticipated costs and benefits, relative to the economic baseline. The proposed amendments would reduce requests to FINRA for exemptions from certain regulatory requirements by replacing these requirements with more practical and transparent alternatives. This in turn will reduce the amount of time FINRA needs for review, allow issuers to access capital markets faster and provide members with more predictable regulatory treatment.

Economic Baseline

The economic baseline for the proposed amendments is the existing regulation framework of public offerings and private placements subject to regulatory oversight under Rules 5110, 5121, and 5123 and their interpretations and implementation by FINRA. The economic baseline also includes industry practices relating to and compliance with these existing regulations and other national and international related standards and regulatory frameworks.

With respect to public offerings subject to Rules 5110 and 5121, FINRA evaluated filing information to assess members' participation in public offerings required to be filed with FINRA. We note that the observations addressed here do not include observations in which members may have relied on a filing exemption under Rule 5110(h)(1). FINRA received 5,403 new filings under Rule 5110 during 2021-2023. The annual number of new filings ranged from 2,901 in 2021 to 1,104 in 2023, with an average number of 1,801 filings per year. These filings represented underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering conducted by 399 members, to the extent the member's participation in the public offering is required to be provided. The average number of filings in which a member participated was seven during the period.

The aggregate amount of offering proceeds in association with the above filings was over $1.32 trillion, with a median value of approximately $100 million per filing. Further, certain proposed amendments to Rule 5110 specifically relate to public offerings with seed capital acquisitions, debt-for-equity transactions and securities acquired by a participating member without a "bona fide public market." FINRA collected information on exemption requests members submitted related to these three sets of acquisitions. An analysis of this data finds that among the 5,403 new public offerings filed under Rule 5110 during 2021-2023, five (0.12 percent) offerings requested exemptions relating to seed capital acquisitions,11 (0.27 percent) offerings requested exemptions relating to debt-for-equity transactions, and nine (0.22 percent) offerings requested exemptions relating to valuing securities without a bona fide public market.[21] FINRA granted a majority of these exemptions after FINRA took into consideration all relevant factors.

With respect to offerings under Rule 5121, 217 (4.0 percent) filings reported conflict(s) of interest under Rule 5121 and 137 (2.5 percent) filings involved participation of a QIU, to the extent this information is required to be provided. As noted above, this data does not include offerings exempt from the filing requirements but subject to rule compliance.

With respect to private placement offerings under Rule 5123, FINRA collected information detailing 9,939 unique filings under Rule 5123 submitted by 513 members during the above period. The annual number of unique filings ranged from 3,811 in 2021 to 2,329 in 2023, with an average number of 3,313 filings per year. Among the 9,939 unique filings, 8,752 (88.1 percent) had projected proceeds totaling $515.8 billion with a median value of $6 million per filing. Projected proceeds were reported as unknown for the remaining filings. The average and median number of these filings submitted per participating member during the above period were 19 and 4, respectively.

Economic Impacts

The proposed amendments would directly impact members, issuers and investors that participate in public offerings and private placements. This economic impact analysis considers the significant impacts associated with specific amendments relating to underwriting compensation and conflicts of interest in public offerings and private placement offerings.

Anticipated Benefits of Proposed Amendments to Rule 5110

Overall, the proposed amendments to Rule 5110 will simplify and clarify the application of Rule 5110 and align the rule with current practice relating to underwriting compensation. The additional flexibility in the proposed amendments will facilitate negotiation between members and issuers of underwriting terms and arrangements that comply with Rule 5110. The proposed amendments will also reduce the need for certain participating members to request exemptions from FINRA, reduce the amount of time for FINRA's review of these filings, allow issuers to access capital markets faster, and enhance the transparency and efficiency of the regulatory process. The codification of the exemptions as safe harbors may lead some members that would not request an exemption under the baseline to use a safe harbor, generating additional or greater investments in issuers thereby increasing access and options to capital raising.

The proposed amendments related to the valuation method for securities acquisitions will increase the options participating members have for receiving underwriting compensation, which may include convertible and non-convertible securities. Currently, participating members in these offerings experience challenges using the market price on the date of the acquisition because a "bona fide public

market" does not exist. Because a value cannot be determined, participating members must either negotiate to be compensated in cash or request an exemption from FINRA because the receipt of such securities would constitute an unreasonable term or arrangement under Rule 5110(g)(1).

Under Rule 5110, transactions involving seed capital investments affiliates of underwriters make in unlisted REITs and DPPs as well as securities affiliates of underwriters acquire in connection with debt-for-equity exchange transactions are deemed underwriting compensation. Hence, participating members must either find alternative financing options or request exemptive relief from the presumption that these transactions may be deemed underwriting compensation.

The proposed amendments to codify these exemptions will reduce compliance costs for participating members insofar as they reduce the time and expense members' employees and outside legal counsel incur in seeking such exemptions. The proposal may also create new financing opportunities for issuers and members and reduce costs associated with such exemptions. The benefits may also extend to offerings exempt from the filing requirements in Rule 5110(h)(1), but otherwise subject to compliance.

Participating members that acquire non-convertible preferred securities in connection with a public offering at a fair price will benefit from the proposed amendments to treat non-convertible preferred securities equivalently to non-convertible or non-exchangeable debt securities. FINRA believes that this proposal will provide participating members additional flexibility and clarity with respect to the applicable requirements for such securities acquisitions under Rule 5110.

Anticipated Costs of Proposed Amendments to Rule 5110

As discussed earlier, the proposed amendments would codify positions FINRA staff take that FINRA does not believe have imposed costs on issuers and investors. The codification may increase future use of the exceptions. FINRA does not expect this change to affect overall underwriting compensation or negatively affect investors, given FINRA's oversight and competitive pressure among underwriters. Therefore, the proposed amendments are not expected to increase costs to issuers and investors that participate and invest in public offerings.

Proposed Amendments to Rule 5121

As discussed above, one of the current conditions that must be met to eliminate the requirement of a QIU participating in a conflicted offering is that the securities offered have a "bona fide public market." Requiring members to measure ADTV and public float has created confusion and frequent interpretive questions regarding appropriate measurement periods, calculation methods and price points. The

proposed amendments replace the requirement of a "bona fide public market" with a standard based on the issuer's capital value and the sufficiency of publicly available information. Therefore, adopting a simpler condition based on market value should benefit members by reducing compliance costs.

In general, FINRA does not believe that the proposed amendments would reduce investor protections relative to the baseline.[22] FINRA believes that the proposed amendments would ensure that sufficient information and research analyst following will be available for investors. Academic research suggests that size is an important indicator of the amount of information that is available about an issuer, and that the amount of information and market value are highly correlated with analyst following[23] and institutional ownership.[24] In addition, the proposed amendments would require the issuer to have been a reporting company for at least one year whereas the current rule only requires 90 days. The extended reporting period should increase the amount of public information available to investors over a longer period of time.

Since the proposed amendments would no longer rely on trading volume, it is possible that issuers with lower trading volume would no longer require participation of a QIU. As trading volume increases with price informativeness,[25] investors may not be able to rely on market price as a source of information for issuers with lower trading volume and the absence of QIU might result in a decrease of objective information and statements in a prospectus to prospective investors. However, this probability is likely to be limited. Based on inputs from the industry and FINRA's experience, FINRA believes that the requirement that the issuer has an aggregate market value of common equity of at least $300 million is likely to ensure that the issuer is followed to a meaningful degree by investors and the research analyst community. Moreover, the one-year reporting company requirement should ensure that sufficient public information is available to investors.

Proposed Amendments to Rule 5123

Lastly, the proposed amendments would expand the scope of private placements that are exempt from the requirement of Rule 5123. The proposed exceptions relate to private placements sold to two additional types of institutional entities that were included in the SEC's amended definition of accredited investor in 2020 (*i.e.*, certain entities and family offices with investments or assets under management in excess of $5,000,000).[26] Members in these offerings would no longer incur the costs to comply with Rule 5123, whereas the regulatory protection provided through the filings requirement is not necessary because the two new categories of accredited investors are considered to have sufficient sophistication to appropriately evaluate the risks and rewards of the investment and therefore warrant an exemption from Rule 5123.

The extent of the cost savings for members cannot be estimated in aggregate because FINRA does not collect the information that would identify the private placement offerings sold exclusively to the above two types of specified institutional entities. The expected cost savings will likely be greater for members that participate in these offerings more frequently or members that seek to expand their private placement activities.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following questions.

- What alternative approaches should FINRA consider?
- Under Rule 5110, FINRA is proposing to replace "bona fide public market" with a valuation method in which the calculation is more predictable and is based on the closing market price of a security traded on a registered national securities exchange or a "designated offshore securities market" on the date of acquisition. Does allowing a valuation method based on the market price without requiring that the security has a "bona fide public market" allow for greater opportunity to influence the value of underwriting compensation?
- Should any securities acquisitions for which FINRA is proposing to provide safe harbors under Rule 5110 be considered underwriting compensation?
- Under Rule 5121, FINRA is proposing to replace the "bona fide public market" condition with a standard that requires the issuer as of the "required filing date" to have been a reporting company for at least one year, be current in its reporting requirements, and have an aggregate market value of common equity of at least $300 million. Is the market capitalization threshold of $300 million an appropriate amount or should there be a different market capitalization threshold? Is the threshold of one year an appropriate reporting history or should there be a different reporting-history threshold?
- Do the proposed amendments result in material economic impacts, including costs and benefits, for investors, issuers and members? If so:
  - What are these economic impacts and what are their primary sources?
  - To what extent would these economic impacts differ by business attributes, such as size of the member or differences in business models?
  - What would be the magnitude of these impacts, including costs and benefits?
- Are there any expected economic impacts associated with the proposal not discussed in this *Notice*? What are they and what are the estimates of those impacts?

Endnotes

1 Parties should submit in their comments only personally identifiable information, such as phone numbers and addresses, that they wish to make available publicly. FINRA, however, reserves the right to redact, remove or decline to post comments that are inappropriate for publication, such as vulgar, abusive or potentially fraudulent comment letters. FINRA also reserves the right to redact or edit personally identifiable information from comment submissions.

2 *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the Federal Register. Certain limited types of proposed rule changes take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

3 *See Regulatory Notice 23-09* (May 2024).

4 As discussed in more detail herein, in August 2020, the SEC adopted amendments to the definition of "accredited investor" under Rule 501. *See* Accredited Investor Definition, Release Nos. 33–10824; 34–89669 (Aug. 26, 2020), 85 FR 64234 (Oct. 9, 2020) (SEC Accredited Investor Definition Release).

5 *See* FINRA's Corporate Financing's Public Offering site for Regulation A+ Limited Review Pilot Program, and Filing Resources for Private Placements.

6 Filings of public offerings are made electronically with FINRA through FINRA's public offering filing system. The filing and review processes are described on the "Public Offerings" page available on the FINRA.org website. The following are some examples of public offerings that are routinely filed: (1) initial public offerings; (2) follow-on offerings; (3) shelf offerings; (4) rights offerings; (5) offerings by direct participation programs as defined in Rule 2310(a)(4); (6) offerings by real estate investment trusts; (7) offerings by a bank or savings and loan association; (8) exchange offerings; (9) offerings pursuant to SEC Regulation A; and (10) offerings by closed-end funds.

7 FINRA does not approve or disapprove an offering; rather, it issues an opinion based on a review that relates solely to the FINRA rules governing underwriting terms and arrangements and the opinion does not purport to express any determination of compliance with any federal or state laws, or other regulatory or self-regulatory requirements regarding the offering. A member may proceed with a public offering only if FINRA has provided an opinion that it has no objection to the proposed underwriting terms and arrangements. *See* Rule 5110(a)(1)(C)(ii).

8 The term "participating member" means any FINRA member that is participating in a public offering, any affiliate or associated person of the member, and any immediate family, but does not include the issuer. *See* Rule 5110(j)(15).

9 *See* Rule 5110(c).

10 *See* Securities Act Rule 902(b).

11 *See* Rules 5110(c)(5) and 5110.06. This construction permits FINRA to deem the debt securities and derivative instruments to be underwriting compensation with a value if FINRA's review indicates that is the case.

12 Under Rule 5121(f)(12), a QIU is a FINRA member that: (i) does not have a conflict of interest and is not an affiliate of a member that has a conflict of interest; (ii) does not beneficially own more than 5 percent of any security that would give rise to a conflict of interest; (iii) has agreed to be liable under Section 11 of the Securities Act with respect to its QIU activities; (iv) can demonstrate its experience as a result of participating as a lead or co-lead manager in at least three public offerings of similar size and type during the past three years; and (v) has no supervisory principals who are responsible for organizing, structuring, or performing due diligence in connection with corporate public offerings of securities who have disciplinary histories.

13 *See Odeon Capital Group LLC*, AWC No. 2021071695501 (Sept. 6, 2024) (describing responsibilities of a QIU).

14 Under Rule 5110(j)(19), the "required filing date" means: (i) no later than three business days after any documents are filed with or submitted to the SEC, including confidential filings or submissions, or any state securities commission or other similar U.S. regulatory authority; or (ii) at least 15 business days prior to the commencement of sales if not filed with or submitted to any such regulatory authority.

15 *See* Rule 5121(f)(5)(C).

16 These "institutional" accredited investors are:

- banks and savings and loan associations; registered broker-dealers; investment advisers; insurance companies; investment companies; business development companies; Small Business Investment Companies; Rural Business Investment Companies; state employee benefit plans with assets in excess of $5 million; or ERISA employee benefit plans, if the investment decision is made by a plan fiduciary, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5 million, or if a self-directed plan, with investment decisions made solely by persons that are accredited investors (*see* Rule 501(a)(1));
- private business development companies (*see* Rule 501(a)(2));
- organizations described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million (*see* Rule 501(a)(3)); and
- trusts with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) (*see* Rule 501(a)(7)).

17 *See* SEC Accredited Investor Definition Release, *supra* note 4.

18 *See* 17 CFR § 230.501(a)(9).

19 *See* 17 CFR § 230.501(a)(12).

20 *See* Investment Company Act Section 2(a)(51).

21 *See* Rule 5110(i). "Pursuant to the Rule 9600 Series, FINRA, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest."

22 FINRA cannot project whether the number of issuers that would require participation of a QIU based on the proposed amendments would increase or decrease from the number under the current requirements. The reason is that the current condition of a "bona fide public market" is complex, involving ADTV which varies greatly with market and economic conditions.

23 *See* Bhushan, R. (1989). Firm characteristics and analyst following. Journal of Accounting and Economics, 11(2-3), 255-274.

24 *See* O'Brien, P. C., & Bhushan, R. (1990). Analyst following and institutional ownership. Journal of Accounting Research, 28, 55-76.

25 *See* Dávila, E., & Parlatore, C. (2018). Identifying price informativeness (No. w25210). National Bureau of Economic Research.

26 *See* SEC Accredited Investor Definition Release, *supra* note 4.

Attachment A

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

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) Requirements for Public Offerings

(1) through (3) No Change.

(4) Documents and Information Required to be Filed

(A) No Change.

(B) Any member filing documents with FINRA pursuant to paragraph (a)(4)(A) must file the following information with respect to the offering in FINRA's Public Offering System:

(i) through (iii) No Change.

(iv) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:

a. non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering must be filed and also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price;

b. non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering; and

c. securities if acquired in accordance with Supplementary Material .01(b) need not be filed.

(v) through (vi) No Change.

(C) through (E) No Change.

(b) No Change.

(c) Valuation of Underwriting Compensation

(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security

A participating member may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:

(A) the security received or the security underlying the warrant or convertible security received is identical to the security offered to the public [or to a security with a bona fide public market]; or

(B) No Change.

(2) Valuation of Non-Convertible Securities

Non-convertible securities received as underwriting compensation will have a compensation value based on:

(A) the difference between:

(i) either the closing market price [per]of the security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b) on the date of acquisition, or[, if no bona fide public market exists for the security,] the public offering price per security; and

(ii) the per security cost;

(B) through (D) No Change.

(3) Valuation of Convertible Securities

Options, warrants or convertible securities ("warrants") shall have a compensation value based on the following formula:

(A) No Change.

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

(i) the closing market price [per]of the convertible security, or the common stock or other security underlying the convertible security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b) on the date of acquisition[, where a bona fide public market exists for the security]; or

(ii) the public offering price per security;

(C) through (H) No Change.

(4) No Change.

(5) Valuation of Securities Acquired in Connection with a Fair Price Non-Convertible [or], Non-Exchangeable Debt or Preferred Securities and Derivative Instruments

Any non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments acquired or entered into at a "fair price" as defined in Supplementary Material .0[6]7(b) and underwriting compensation received in or receivable in the settlement, exercise or other terms of such non-convertible [or], non-exchangeable debt or preferred securities and derivative instruments shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments [is] are not at a fair price, compensation will be calculated

pursuant to this paragraph (c) or based on the difference between the fair price and the actual price.

(d) No change.

(e) Lock-Up Restriction on Securities

(1) No Change.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (e)(1):

(A) the lock-up restriction will not apply:

(i) through (iii) No Change.

(iv) to a non-convertible or non-exchangeable debt, or preferred security acquired in a transaction related to the public offering;

(v) through (ix) No Change.

(B) No Change.

(f) No Change.

(g) Unreasonable Terms and Arrangements

Without limiting the requirements of paragraph (a)(1)(A) of this Rule, the following terms and arrangements are prohibited:

(1) through (4) No Change.

(5) any underwriting compensation in connection with a public offering that is not completed according to the terms of an agreement entered into by an issuer and a participating member, except

(A) No Change.

(B) a termination fee, a tail fee or a right of first refusal, as set forth in a written agreement entered into by an issuer and a participating member, provided that:

(i) No Change.

(ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee, tail fee or provision of any right of first refusal;

(iii) the amount of any termination fee or tail fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv) the issuer shall not be responsible for paying the termination fee or tail fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer;

(6) through (11) No Change.

(h) Exemptions

(1) Offerings Exempt from Filing

Documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of Rule 5121(a)(1[2])(A)(i), provided that the following public offerings must comply with this Rule and, if applicable, Rules 2310 and 5121:

(A) securities offered by a bank, foreign bank, corporate issuer, foreign government or foreign government agency that has outstanding unsecured non-convertible debt with a term of issue of at least four years or unsecured non-convertible preferred securities that are investment grade rated, as defined in Rule 5121(f)([8]7), or are outstanding securities in the same series that have equal rights and obligations as investment grade rated securities, provided that an initial public offering of equity is required to be filed;

(B) through (G) No Change.

(2) No Change.

(i) No Change.

(j) Definitions

The definitions in Rule 5121 are incorporated herein by reference. For purposes of this Rule, the following terms have the meanings stated below:

(1) through (7) No Change.

(8) Immediate Family

The term "immediate family" means:

(A) the spouse or children of an associated person of a member; and

(B) No Change.

(9) through (22) No change.

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

.01 Underwriting Compensation

(a) No Change.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) through (18) No Change.

(19) non-convertible or non-exchangeable debt, or preferred securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) through (22) No Change.

(23) securities acquired by a lender affiliated with a participating member through a debt-for-equity exchange that is sold by its affiliated member, if:

(A) the debt-for-equity exchange was structured to provide economic and tax benefits to the issuer and not the lender or affiliated member, except for the compensation in subparagraph (D) of this Supplementary Material .01(b)(23);

(B) the affiliated member subsequently offered all of the equity securities acquired by the lender in an offering following the debt exchange;

(C) the terms negotiated in connection with the debt exchange and the subsequent equity offering were determined through arms' length negotiations based on the market price of the equity exchanged, subject to the compensation in subparagraph (D) of this Supplementary Material .01(b)(23);

(D) the affiliated member negotiated customary compensation for an equity public offering; and

(E) the equity public offering was structured as a firm commitment offering.

(c) No Change.

.02 Venture Capital Transactions and Significantly Delayed Offerings. Notwithstanding paragraph (d) of this Rule, in the event that an offering is significantly delayed and the issuer needs funding pending consummation of the public offering, FINRA may exclude from underwriting compensation any securities acquired in a transaction that otherwise meets the requirements in paragraph (d), but occurs after the required filing date. To determine whether an acquisition of securities that occurs after the required filing date may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.03 Underwriting Compensation Securities Acquired Other than from the Issuer. Notwithstanding paragraph (j)(22) of this Rule, FINRA may exclude securities acquired from a third-party entity from underwriting compensation. To determine whether an acquisition of

securities from a third-party entity may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.04 Underwriting Compensation Resulting from Issuer Directed Sales Programs. Notwithstanding paragraph (j)(15) and (22) of this Rule, FINRA may exclude from underwriting compensation securities acquired by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program. To determine whether an acquisition of securities by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.05 Seed Capital Investments. Notwithstanding paragraph (j)(22) of this Rule, FINRA may exclude securities acquired by a participating member in the issuer or an affiliated entity, in connection with the investment of cash to capitalize a direct participation program or a real estate investment trust, as defined Rule 2231(d), provided that:

(a) the acquisition of securities is disclosed in the issuer's prospectus as a seed capital investment or a comparable form of capitalization;

(b) the securities offered to the public and the securities acquired in the capitalization transaction are valued and priced on a net asset value or NAV basis;

(c) the offering for which the participating member is engaged is an offering subject to the requirements of Rule 2310; and

(d) the securities acquired and excluded are not sold, transferred, assigned, pledged or hypothecated, or be the subject of any hedging, short sale, derivative, put or call transaction that would result in the effective economic disposition of the securities for a period of 180 days beginning on the date of commencement of sales of the public equity offering.

.06 Disclosure of Underwriting Compensation. A description of each item of underwriting compensation received or to be received by a participating member must be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document). The description shall include the dollar amount ascribed to each individual item of compensation. When securities are acquired by a participating member, material terms and arrangements of the acquisition must also be disclosed in the section on distribution arrangements in the prospectus (or other similar offering document) when applicable, such as exercise terms, demand and piggyback registration rights and lock-up periods that may apply. Similarly, if underwriting compensation consists of a right of first refusal to participate in the distribution of a future public offering, private placement or other financing, the description should reference the existence of such right and its duration.

.[06]07 Non-Convertible [or], Non-Exchangeable Debt or Preferred Securities and Derivative[s] Instruments

(a) Non-convertible [or], non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation value. Non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule.

(b) The term “derivative instrument” means any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term “fair price” means the participating members have priced a derivative instrument or non-convertible [or], non-exchangeable debt or preferred security in good faith; on an arm’s length, commercially reasonable basis, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit

facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price.

.[07]08 Venture Capital Transactions. The determination of whether a securities acquisition may be excluded from underwriting compensation pursuant to paragraph (d) of this Rule is to be made at the time of the securities acquisition.

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[1] The current annual amount fixed by the Board of Governors is $100.

* * * * *

5121. Public Offerings of Securities [W]with Conflicts of Interest

(a) Requirements for Participation in [Certain] Public Offerings with a Conflict of Interest

(1) General

(A) No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraph (i) or (ii)[(1) or (2)].

(i)[(1) There must be prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering, and one of the following conditions must be met:] A qualified independent underwriter has participated in the offering and meets the requirements of paragraph (a)(3) of this Rule; or

(ii) The offering can meet one of the following conditions:

a.[(A) the] each member[(s)] that is primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirements of paragraph (a)(3)(A)(vi)[(f)(12)(E)];

[(B) the securities offered have a bona fide public market; or]

b.[(C)] as of the required filing date, the securities offered are investment grade rated or are securities in the same series that have equal rights and obligations as investment grade rated securities; or[.]

c. as of the required filing date, the securities are offered by an issuer that has (i) been reporting under the Exchange Act for at least one year, (ii) is current in its reporting requirements, and (iii) its common equity securities have an aggregate market value of at least $300 million.

(2) Duties and Obligations of a Conflicted Member(s)

(A) A member(s) that has a conflict(s) of interest must: [A qualified independent underwriter has participated in the preparation of the registration statement and the prospectus, offering circular, or similar document and has exercised the usual standards of "due diligence" in respect thereto; and

(B) there must be prominent disclosure in the prospectus, offering circular or similar document for the offering of:]

(i) [the nature of the]ensure its conflict(s) of interest is prominently disclosed in the registration statement that must include:[;]

a. a description of the conflict(s) of interest including identification of the conflicted member(s);

b. [(ii)]if applicable, the name of the member acting as the qualified independent underwriter; and

c. [(iii)]if applicable, a brief statement regarding the role and responsibilities of the qualified independent underwriter[.]; and

(ii) make prominent disclosure in the registration statement by:

a. providing the notation "(Conflicts of Interest)" following the listing of the Plan of Distribution in the Table of Contents section required in Item 502 of SEC Regulation S-K, and by providing such disclosures in the Plan of Distribution section required in Item 508 of SEC Regulation S-K and any Prospectus Summary section required in Item 503 of SEC Regulation S-K; or

b. for an offering document not subject to SEC Regulation S-K, by providing disclosure on the front page of the offering document that a conflict of interest exists, with a cross-reference to the discussion within the offering document and in the summary of the offering document if one is included.

(B) if required by paragraph (a)(1)(A)(i), a conflicted member must:

(i) engage or ensure a qualified independent underwriter is engaged, once it determines any conflict of interest exists and before the commencement of sales;

(ii) retain the confirmation provided by the qualified independent underwriter as required in paragraph (a)(3)(B) in its records; and

(iii) ensure there is a written agreement that details the services to be provided by the qualified independent underwriter and reflects the amount, if any, of all qualified independent underwriter compensation.

(3) Duties and Obligations of a Qualified Independent Underwriter

(A) A qualified independent underwriter must:

(i) not have a conflict of interest and must not be an affiliate of any member that has a conflict of interest;

(ii) not beneficially own, as of the date of the member's participation in the public offering, more than 5% of the class of securities

that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days following the later of the effective date or the final closing of the offering;

(iii) have entered into a written agreement required in paragraph (a)(2)(B)(iii) of this Rule that provides the member is participating as a qualified independent underwriter within the meaning of this Rule and discloses the services to be provided by the qualified independent underwriter and any compensation for such services as applicable;

(iv) undertake the responsibilities and liabilities of an underwriter under the Securities Act, specifically including those inherent in Section 11, and agree to exercise the usual standards of due diligence in respect thereto;

(v) have served as an underwriter for at least three years prior to its engagement as a qualified independent underwriter and participated in at least three public offerings of a similar size and type. This requirement will be deemed satisfied if, during the past three years, the member:

a. with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with offering proceeds of not less than 25% of the anticipated offering proceeds of the proposed offering; or

b. with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with

offering proceeds of not less than 50% of the anticipated offering proceeds of the proposed offering; and

(vi) not have any associated person who functions in a supervisory capacity who is responsible for organizing, structuring, or performing due diligence with respect to public offerings of securities that:

a. has been convicted within 10 years prior to the preparation and filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;

b. is subject to any order, judgment, or decree of any court of competent jurisdiction entered within 10 years prior to the preparation and filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or

c. has been suspended or barred from association with any member by an order or decision of the SEC, any state, FINRA or any other self-regulatory organization within 10 years prior to the preparation and filing of the registration statement, or the

preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.

(B) A qualified independent underwriter must provide confirmation to the member(s) that has a conflict of interest that it participated in the preparation of the registration statement and exercised the usual standards of due diligence in respect thereto.

(b) Escrow of Proceeds[;] Net Capital Computation

(1) through (2) No Change.

(3) Any member offering its securities pursuant to this Rule shall disclose in the registration statement[, offering circular or similar document] a date by which the offering is reasonably expected to be completed and the terms upon which the proceeds will be released from the escrow account described in paragraph (b)(1).

(c) Discretionary Accounts

Notwithstanding Rule 3260 [NASD Rule 2510], no member that has a conflict of interest may sell to a discretionary account any security with respect to which the conflict exists, unless the member has received specific written approval of the transaction from the account holder and retains documentation of the approval in its records.

(d) Application of Rule 5110

Any public offering subject to paragraph (a)[(2)](1)(A)(i) is subject to [Rule 5110, whether or not the offering would be otherwise exempted from] the filing and[or] other requirements of Rule 5110[that rule].

(e) Requests for Exemption from Rule 5121

Pursuant to the Rule 9600 Series, FINRA, for good cause shown after [may in exceptional and unusual circumstances,] taking into consideration all relevant factors, [exempt a member] may conditionally or unconditionally grant an exemption [or on specified terms] from any [or all of the] provision[s] of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest[it deems appropriate].

(f) Definitions

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

(1) through (2) No Change.

(3) [Bona Fide Public Market]

[The term "bona fide public market" means a market for a security of an issuer that has been reporting under the Exchange Act for at least 90 days and is current in its reporting requirements, and whose securities are traded on a national securities exchange with an Average Daily Trading Volume (as provided by SEC Regulation M) of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million.]

[(4)]Common Equity

The term "common equity" means the total number of shares of common stock outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

(4[5]) Conflict of Interest

The term "conflict of interest" means, if at the time of a member's participation in an entity's public offering, any of the following applies:

(A) the securities are to be issued by the member;

(B) the issuer controls, is controlled by or is under common control with the member or the member's affiliate or associated persons;

(C) through (D) No Change.

Subparagraph (6) through subparagraph (10) renumbered as subparagraph (5) through subparagraph (9).

(11) [Prominent Disclosure]

[A member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B) by:]

[(A) providing the notation "(Conflicts of Interest)" following the listing of the Plan of Distribution in the Table of Contents section required in Item 502 of SEC Regulation S-K, and by providing such disclosures in the Plan of Distribution section required in Item 508 of SEC Regulation S-K and any Prospectus Summary section required in Item 503 of SEC Regulation S-K; or]

[(B) for an offering document not subject to SEC Regulation S-K, by providing disclosure on the front page of the offering document that a conflict exists, with a cross-reference to the discussion within the offering document and in the summary of the offering document if one is included.]

[(12) Qualified Independent Underwriter]

[The term "qualified independent underwriter" means a member:]

[(A) that does not have a conflict of interest and is not an affiliate of any member that has a conflict of interest;]

[(B) that does not beneficially own as of the date of the member's participation in the public offering, more than 5% of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days;]

[(C) that has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act, specifically including those inherent in Section 11 thereof; and]

[(D) that has served as underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering without a registration statement. This requirement will be deemed satisfied if, during the past three years, the member:]

[(i) with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering; and]

[(ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering.]

[(E) none of whose associated persons who function in a supervisory capacity who is responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:]

[(i) has been convicted within ten years prior to the filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or

regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;]

[(ii) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or]

[(iii) has been suspended or barred from association with any member by an order or decision of the SEC, any state, FINRA or any other self-regulatory organization within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.]

(10[3]) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act; notification on Form 1A filed with the SEC pursuant to the provisions of Securities Act Rule 252; or any other document, by whatever name known, initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any federal or state agency.

[(14) Subordinated Debt]

[The term "subordinated debt" includes (A) debt of an issuer which is expressly subordinate in right of payment to, or with a claim on assets subordinate to, any existing or future debt of such issuer; or (B) all debt that is specified as subordinated at the time of issuance. Subordinated debt shall not include short-term debt with maturity at issuance of less than one year and secured debt and bank debt not specified as subordinated debt at the time of issuance.]

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

.01 Lead Members

(a) Role of Primarily Responsible Member(s). One condition of paragraph (a)(1)(A)(ii) of this Rule is that the member primarily responsible for managing the public offering (i.e., the book-running lead manager(s) or lead placement agent(s)) must not have a conflict of interest and is not an affiliate of a member that has a conflict of interest. If the member primarily responsible for managing the public offering cannot meet these requirements, one of the conditions in paragraphs (a)(1)(A)(i), (a)(1)(A)(ii)b. or (a)(1)(A)(ii)c. must be met in order for the conflicted member(s) to participate in the offering.

If two or more members that are primarily responsible for managing the public offering share responsibilities with regard to due diligence, each must be free of conflicts of interest, otherwise one of the conditions in paragraph (a)(1)(A)(i), (a)(1)(A)(ii)b. or (a)(1)(A)(ii)c. must be met in order for the conflicted member(s) to participate in the offering.

In some best efforts offerings, there is not a member that is primarily responsible for managing the offering. Under such circumstances, a conflicted member(s) must meet one of the conditions in paragraph (a)(1)(A)(i), (a)(1)(A)(ii)b. or (a)(1)(A)(ii)c. to participate in the offering.

(b) Engagement of a Qualified Independent Underwriter. If a qualified independent underwriter is required to comply with paragraph (a)(1)(A) of this Rule, one of the members primarily responsible for managing the public offering, or any other member participating in the

offering, may act as the qualified independent underwriter if it meets the requirements of paragraph (a)(3) of this Rule.

.02 Services and Compensation of a Qualified Independent Underwriter. A qualified independent underwriter's responsibility to perform reasonable due diligence applies to all public offerings that require a qualified independent underwriter. A qualified independent underwriter is expected to participate in the preparation of the registration statement and perform due diligence if engaged prior to the initial filing of the registration statement. While a qualified independent underwriter that is retained after the registration statement has been filed cannot participate in the "preparation" of the registration statement as originally filed, it can conduct due diligence and require the issuer to amend the registration statement disclosures if necessary. If a member has not been afforded appropriate time in which to complete its due diligence prior to commencement of sales, it is not qualified to act as a qualified independent underwriter.

To the extent any compensation is paid to a member, from any source, for acting as the qualified independent underwriter in a public offering, it should be commensurate with the level of services performed and does not exceed the customary costs for related services. Qualified independent underwriter compensation must be disclosed in the section on distribution arrangements in the registration statement as required by Rule 5110(b) and Rule 5110.05.

.03 Economic Interest in Offering Proceeds. Rule 5121(f)(4)(C) provides that a conflict of interest arises when at least five percent of the net offering proceeds, excluding underwriting compensation, are directed to a member, its affiliates and associated persons. This type of conflict of interest only applies if the participating member and its related affiliates and associated persons have an economic interest in the proceeds and does not include proceeds held in brokerage accounts on behalf of a member's customer.

* * * * *

5123. Private Placements of Securities

(a) No Change.

(b) Exemptions

The following private placements are exempt from the requirements of this Rule:

(1) offerings sold by the member or person associated with the member solely to any one or more of the following:

(A) through (I) No Change.

(J) accredited investors described in Securities Act Rule 501(a)(1), (2), (3), [or] (7), (9) or (12).

(2) through (14) No Change.

(c) through (d) No Change.

EXHIBIT 2b

Alphabetical List of Written Comments
Regulatory Notice 24-17

1. Michael Arnold, Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association ("ABA") (March 17, 2025)

2. Joseph Corcoran, Securities Industry and Financial Markets Association, ("SIFMA") (March 20, 2025)

3. Anya Coverman, Institute for Portfolio Alternatives ("IPA") (March 20, 2025)

4. John H. Grady, Alternative & Direct Investment Securities Association ("ADISA") (March 18, 2025)

5. Daniel H. Kolber, Intellivest Securities, Inc. ("Intellivest") (December 24, 2024)

6. Alice L. Stewart, Rachael T. Shaw, Amit Levin, & Krina Patel, University of Pittsburgh School of Law Securities Arbitration Clinic ("U Pitt") (March 20, 2025)

Exhibit 2c

March 17, 2025

Submitted via email to: pubcom@finra.org

Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1700 K Street, N.W.
Washington, D.C. 20006

Re: Regulatory Notice 24-17: Request for Comment on Proposed Changes to FINRA Corporate Financing Rules

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") in response to the request for comments by the Financial Industry Regulatory Authority, Inc. ("FINRA") pursuant to FINRA Regulatory Notice 24-17 (the "Notice"), as more fully set forth below.

This letter was prepared by members of the Committee's Subcommittee on FINRA Corporate Financing Rules. The views expressed in this letter represent the views of the Committee only and have not been reviewed or approved by the House of Delegates or Board of Governors of the ABA and should not be construed as representing the position of the ABA. In addition, this letter does not necessarily reflect the views of all members of the Section, the Committee, the drafting committee or their respective firms or clients.

I. Description of the Notice

The Committee commends the significant steps already taken by FINRA to promote and reduce unnecessary burdens on capital formation. The Notice requests comment on proposed amendments to FINRA Rules 5110, 5121 and 5123 to make substantive, organizational and terminology changes to such rules. The proposed amendments respond to feedback FINRA received with respect to Regulatory Notice 23-09.

The Committee supports FINRA's efforts to continue to modernize its rules, simplify compliance and codify additional exceptions from underwriting compensation. The Committee also welcomes the opportunity to suggest further improvements that would be consistent with FINRA's goals set forth in the Notice and in Regulatory Notice 23-09, as discussed below.

II. Comments

A. Rule 5110

1. Rule 5110(c)(1) – Limitation on Securities Received upon Exercise or Conversion of Another Security

In Rules 5110(c)(2)(A) and (c)(3)(B), FINRA proposes to replace references to a "security with a bona fide public market" with a "security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b)." However, in Rule 5110(c)(1)(A) FINRA proposes to delete the words "or to a security with a bona fide public market" without substituting the alternative of a security traded on a U.S. exchange or designated offshore market, as follows:

> A participating member may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:
>
> (A) the security received or the security underlying the warrant or convertible security received is identical to the security offered to the public [or to a security with a bona fide public market]…

Thus, the new valuation methods in paragraphs (c)(2)(A) and (c)(3)(B) for securities traded on U.S. exchanges and offshore markets will be without effect since paragraph (c)(1)(A) would not allow FINRA members to receive securities as underwriting compensation that are different than those offered to the public.[1]

We believe allowing underwriters to receive securities that are either identical to the security offered to the public *or* capable of valuation because they are traded on a U.S. national exchange or designated offshore market is consistent with and necessary

[1] Rule 5110(c)(1)(B) is not proposed to be amended and, therefore, would continue to allow the staff to determine that a security being received as underwriting compensation that is different than the security offered to the public is permitted if it "can be accurately valued." However, this alternative valuation method has no meaning since there is no proposal to include standards for when such other securities "can be accurately valued."

to the implementation of the changes made elsewhere in Rule 5110(c) and would provide certainty to issuers and the investing public. The limitation in Rule 5110(c)(1)(A) is designed to prevent underwriters from negotiating compensation for themselves in the form of securities with rights and other terms not available to other investors. That concern is not present when the securities received by underwriters are traded on U.S. national exchanges or designated offshore securities markets,[2] because the securities can be acquired at market prices by any investor.

In addition, we believe the foregoing concern is also not present when the securities received by underwriters are traded on over-the-counter markets where the securities can be acquired at market prices by any investor. Those of us who have had a FINRA underwriting practice for many years remember a time when FINRA staff, acting pursuant to authority to determine the existence of a bona fide independent market, concluded in appropriate cases that the last sale price of a security traded in the over-the-counter ("OTC") market could be used on the basis that the market price was independently determined. Therefore, we believe that Rule 5110(c) should also permit valuation of any security traded on any of the OTC markets of the OTC Markets Group, Inc. (the "OTC Markets") that is eligible for proprietary quotation by an OTC Market Maker, as defined in FINRA Rule 6420.[3] Due to the standards for inclusion in these OTC Markets, as well as FINRA's oversight, we believe that the independently

[2] Clause (b)(1) of Securities Act Rule 902 lists specific markets that qualify as designated offshore securities markets, while clause (b)(2) permits the SEC to so designate additional foreign securities markets. Such designations are generally made through the SEC no action letter process. For SEC no action letters in this area, see https://www.sec.gov/rules-regulations/no-action-interpretive-exemptive-letters/division-corporation-finance-no-action#regs, under heading "Regulation S - Offers and sales made outside the United States". A single, publicly available list of all designated offshore securities markets, if FINRA were to maintain one, would offer the benefits of uniformity and efficiency to the process of identifying qualifying offshore markets for the purpose of establishing valuation.

[3] OTC Market Makers must comply with Exchange Act Rule 15c2-11, which governs the publication of quotations for securities in the OTC market for the purpose of preventing fraud and manipulation by requiring broker/dealers to review current and publicly available information about an issuer before quoting its securities. FINRA is responsible for review and approval of Rule 15c2-11 compliance prior to a broker/dealer first entering a quotation in an OTC security and, for this purpose, enforces requirements to ensure such compliance in FINRA Rule 6432.

determined market prices in such markets make further criteria such as the trading price and volume unnecessary.[4]

For these reasons, we recommend that Rules 5110(c)(2) and (c)(3) be revised as discussed below and that Rule 5110(c)(1)(B) be revised as follows:

> (B) the security can be accurately valued~~, as required by paragraph (g)(1) of this Rule~~ **pursuant to any method in this paragraph (c), without limitation on FINRA's authority to accept other valuation methods as accurate.**

2. Rule 5110(c)(2) – Valuation of Non-Convertible Securities

FINRA proposes the following amendment to Rule 5110(c)(2)(A):

> (A) the difference between:
>
> (i) either the closing market price [per]of the security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b) on the date of acquisition, or[, if no bona fide public market exists for the security,] the public offering price per security; and
>
> (ii) the per security cost…

The provision as currently written contains a mechanism for determining which of two prices should be used: the public offering price is used *unless* a bona fide public market price exists. The provision as proposed to be amended does not say which price should be chosen or if the underwriters are free to choose which of the prices they prefer. As a practical matter, an offering of securities that are also traded on an exchange or offshore market will generally be at a price below the market price, as an incentive to purchasers in the offering. Since FINRA has described one of the purposes of this rule

[4] To qualify for the OTCQX market, among other things, companies must meet high financial standards, follow best practice corporate governance, maintain compliance with U.S. securities laws, meet the infrequently-traded and disclosure standards of SEC Rule 15c2-11, be current in their disclosure, and have a professional third-party sponsor (broker/dealer) introduction. Penny stocks, shell companies and companies in bankruptcy cannot qualify for the OTCQX. To qualify for the OTCQB market, among other things, companies must maintain a corporate profile, publish an annual certification, maintain compliance with U.S. securities laws, be current in filing obligations and not be in bankruptcy. See also, the OTCQX and OTCQB Disclosure Guidelines at https://www.otcmarkets.com/files/OTCQX-OTCQBGuidelines.pdf. Effective July 1, 2025, the OTCID Basic Market will replace the Pink Current Market. Companies traded on the OTCID Basic Market will provide ongoing financial disclosure and a management certification. Companies will also be required to verify their profile for U.S. investors, brokers and regulators. See also, OTCID Rules, effective July 1, 2025, at https://www.otcmarkets.com/files/OTCIDRules.pdf and https://www.otcmarkets.com/files/15c211_Market_Chart_EffectiveJul2025.pdf for a comparison chart of OTC markets and an explanation of "proprietary quote eligible".

change to be to make the valuation method "more predictable" and because of the reasons stated above, we suggest that the proposed provision be revised to track the current decision tree, as shown in bold below:

> (i) ~~**either**~~ the closing market price **on the date of acquisition** [per]of the security traded on **(a)** a U.S. registered national securities exchange**, (b)** ~~**or**~~ a designated offshore securities market as defined under Securities Act Rule 902(b)**, or (c) any market of the OTC Markets Group, Inc. where the security is eligible for proprietary quotation by an OTC Market Maker, as defined in Rule 6420** ~~**on the date of acquisition,**~~ or**, if no qualifying market price exists for the security,**[, if no bona fide public market exists for the security,] the public offering price per security; and

3. Rule 5110(c)(3) – Valuation of Convertible Securities

For the reasons stated above with respect to Rule 5110(c)(2), we suggest that Rule 5110(c)(3)(B) be revised to read as follows, with proposed changes shown in bold:

> (B) minus the resultant of the exercise or conversion price per warrant less ~~**either**~~:
>
> (i) the closing market price **on the date of acquisition** [per]of the convertible security, or the common stock or other security underlying the convertible security traded on **(a)** a U.S. registered national securities exchange**, (b)** ~~**or**~~ a designated offshore securities market as defined under Securities Act Rule 902(b)**, or (c) any market of the OTC Markets Group, Inc. where the security is eligible for proprietary quotation by an OTC Market Maker, as defined in Rule 6420** ~~**on the date of acquisition**~~[, where a bona fide public market exists for the security]; or
>
> (ii) **if no qualifying market price exists for the security,** the public offering price per security…

4. Rule 5110(c)(5) and .07 Supplementary Material – Valuation of Securities Acquired in Connection with Fair Price Non-Convertible, Non-Exchangeable Debt or Preferred Securities and Derivative Instruments

We support FINRA's proposal to treat non-convertible preferred securities like non-convertible debt securities for purposes of the Rule 5110 safe harbor providing that such securities acquired in a transaction related to a public offering at a fair price are considered underwriting compensation but will have no compensation value. However,

sometimes issuers must conduct conversions of outstanding securities, such as non-convertible preferred stock, as part of recapitalizations or other reorganizations in preparation for an initial public offering ("IPO") and to meet stock exchange listing standards. The participating FINRA members have no control over such transactions.

If the original acquisition of preferred securities meets the safe harbor, such a conversion of preferred securities in preparation for an IPO should not prohibit reliance on the safe harbor. Therefore, we suggest that FINRA clarify that reliance on this safe harbor is not prohibited where the otherwise non-convertible preferred securities nevertheless convert into the class of securities to be sold to the public as part of a recapitalization or other reorganization in preparation for an IPO.

5. Rule 5110(g)(5) – Tail Fee

FINRA proposes to impose conditions on terms in underwriting agreements providing for the receipt of tail fees similar to the conditions in Rule 5110(g)(5) applicable to termination fees and rights of first refusal. In keeping with the intention of FINRA to provide greater certainty concerning the meaning and requirements of the provisions of Rule 5110, we recommend that FINRA define the term "tail fee," and differentiate it from a "termination fee." One way to do that would be to add a definition of "tail fee" to paragraph (j) of the rule, based on the language in Notice 24-17, under the heading "Operational Changes," providing in substance as follows:

> (j) Definitions
>
> (*) Tail Fee
>
> The term "tail fee" means a fee in an agreement between a member firm and an issuer or seller of securities in a public offering subject to this Rule providing compensation to the member firm in the event of a subsequent financing from investors introduced by a member, following the termination of the agreement. A tail fee is different from a termination fee, although they are both paid following termination of the agreement, in that the termination fee is payable upon the occurrence of a subsequent financing, without regard to whether the investors in the subsequent financing were introduced by the member firm.

In the case of a tail fee, the value of the member's services may consist entirely or primarily of investor introductions. Therefore, we believe that the condition in paragraph (g)(5)(B)(iii) should be revised to incorporate that fact. We suggest the addition of the language shown here with bold underlining:

> (iii) the amount of any termination fee or tail fee must be reasonable in relation to the underwriting services contemplated in the agreement **(which, in the case of**

a tail fee, may consist wholly or in part of introductions to investors who invest in later financings) and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and…

6. Supplementary Material .01(b)(23) – Items Not Considered Underwriting Compensation – Debt-for-Equity Exchanges

We support FINRA's proposal to permit an affiliate of a member participating in a public offering to receive securities not considered underwriting compensation as a lender in a debt-for-equity exchange. However, we suggest that FINRA clarify that reliance on this exception is not prohibited where the affiliated member offers, but is unable to sell, all of the equity securities acquired by the lender in an offering following the debt exchange. Accordingly, we suggest adding the following clarifying language at the end of the exception:

Notwithstanding the foregoing, the affiliated member is not prohibited from placing a portion of the equity securities acquired by the lender in its investment account if it is unable to sell that portion in the offering as required by clause (B).

7. Rule 5110 Supplementary Material .05 – Seed Capital Investments

We also support FINRA's proposal in Rule 5110 supplementary material .05 to provide an exception from underwriting compensation for seed capital investments made by affiliates of underwriters. The proposed exception sets out conditions and would create a principles-based approach for excluding seed capital investments from underwriting compensation. Because the principles-based approach will inherently result in some discretion as to whether or not the exception applies in a particular offering, which could result in inconsistent outcomes, we suggest that FINRA provide more guidance as to application of the exception.

Accordingly, we suggest that the exception specifically address the following:

- the timing of investment (i.e., that the investment may occur prior to, or concurrently with, the public offering);
- that seed capital investments need not be of the same class of securities as those offered to the public so long as the securities are priced at NAV; and
- that seed capital investments could be made through an acquisition in a public offering or private placement.

B. Rule 5121

1. Rule 5121(a)(1)(A)(ii)b. – Exception from Qualified Independent Underwriter ("QIU") Requirement for Investment Grade Rated Securities

With respect to the exception from the QIU requirement in Rule 5121(a)(1)(A)(ii)b., FINRA proposes to require that "as of the required filing date," the securities offered are investment grade rated . . . ." The "required filing date" in Rule 5110(j)(19) means the dates referenced in Rule 5110(a)(3) and, for offerings exempt from filing under Rule 5110(h), "the date the public offering would have been required to be filed with FINRA but for the exemption." Rule 5110(a)(3) requires a FINRA filing no later than three business days after documents are filed with or submitted to the SEC. With respect to shelf registration statements that would have been required to be filed but for an exemption under Rule 5110(h), such required filing date would occur before pricing the first takedown from the shelf in which a FINRA member participates.

Therefore, we believe that the "required filing date" is the incorrect compliance date for this requirement. Participating FINRA members will not be able to comply with this proposed timing requirement because the final investment grade ratings are not confirmed as of the required filing date for a public offering, but between pricing and closing. The rating process is driven by the issuer with the issuer presenting to the rating agencies and receiving an "expected" rating for the issue ahead of any investment grade debt offering. Expected ratings are then conveyed by the rating agencies during the course of an applicable offering and are incorporated into the governing documents and are generally included in pricing term sheets. The final confirmation of the investment grade ratings is generally provided by rating agencies on a date between the pricing and closing dates of an offering. We are not aware of investment grade debt offerings where the anticipated investment grade ratings were subsequently downgraded to less than investment grade ratings between pricing and closing the offering. Nevertheless, if this were to happen, we anticipate that the offering would be delayed to update disclosure and the terms of the offering and such delay would enable the engagement and participation of a QIU, if required. For these reasons, we recommend that subparagraph (a)(1)(A)(ii)b. remain as is and not be amended to reference "as of the required filing date". Alternatively, if FINRA believes an amendment to this provision is necessary, we believe that the closing date of the offering would be a more appropriate timing and would recommend that that subparagraph (a)(1)(A)(ii)b. be revised as follows in bold:

~~as of the required filing date~~ **as of the closing date of the offering**, the securities offered ~~are~~ **will be** investment grade rated or ~~are~~ **will be** securities in the same series that have equal rights and obligations as investment grade rated securities; or[.]

2. Rule 5121(a)(1)(A)(ii)c. – Exception from QIU Requirement for Certain Securities

In Rule 5121, FINRA proposes eliminating the definition of "bona fide public market" and, in subparagraph (a)(1)(A)(ii)c., replacing that exception from the QIU requirement with an exception where:

> as of the required filing date, the securities are offered by an issuer that has (i) been reporting under the Exchange Act for at least one year, (ii) is current in its reporting requirements, and (iii) its common equity securities have an aggregate market value of at least $300 million.

We believe that replacing "as of the required filing date" with "as of the date of commencement of sales" (i.e., the pricing date) in the foregoing is consistent with amendments proposed elsewhere in Rule 5121 and with FINRA's goal of clarifying and making explicit the provision's requirements and addresses the timing concerns caused by relying on the definition of required filing date. An issuer that may not meet the forgoing conditions at the time of the initial confidential submission in connection with a non-shelf follow-on offering, may meet such conditions by the time the offering prices. In addition, we believe that the appropriate time to apply the conditions of this provision to a shelf takedown is as of the date of commencement of sales (i.e., the pricing date).

In addition, this exception is relied on not only when securities are offered *by* an issuer, but also when securities are offered for resale *by* a selling security holder. Therefore, we suggest that the relevant proposed language in the first line above be modified to read "the issuer of the securities offered has . . ."

With respect to the length of time required to be a reporting company under the Exchange Act, we believe that a period shorter than the proposed one year is sufficient. We propose that an issuer be required to have been reporting under the Exchange Act for at least 180 days instead of one year. Reporting under the Exchange Act for at least 180 days will ensure that sufficient public information about the issuer is available as a result of multiple SEC filings.

We are also concerned that replacing "public float value" with "aggregate market value" may cause confusion regarding the calculation because the term could be read to include privately placed securities with a private trading market. It is clear from the request for comment section on page 13 of the Notice that FINRA intends the calculation to be based on the more widely-used term "market capitalization," which is

the term that FINRA also explains in detail on its website location for educating investors.[5] Accordingly, we recommend that FINRA incorporate in this provision the term "market capitalization," which is the term used by the U.S. markets and financial reporting sites when displaying the total number of outstanding securities of a traded issue multiplied by the security's current market price, with updates during the day to reflect the current market price. If this calculation is not published, it can nonetheless be easily calculated at any time based on the total shares outstanding and the current market price.

Finally, FINRA has proposed increasing the required value of common equity securities to at least $300 million in this provision because it believes this will ensure such companies are followed to a meaningful degree by investors and the analyst community, which should result in an increase in public information about those companies. Micro-cap companies have a market value of less than $250 million, while small-cap companies have a market cap between $250 million and $2 billion.[6] We do not believe there is an appreciable difference in the amount of publicly available information due to analyst coverage and institutional ownership for micro-cap and small-cap companies with market capitalizations between $150 million and $300 million. In addition, today there are more avenues of independent public information about companies across market capitalization values through increased public coverage of companies by the financial press.

Accordingly, we propose that a global market capitalization of $150 million be reflected in this provision. Alternatively, if FINRA disagrees with this threshold, we propose that a global market capitalization of $250 million be reflected in this provision because this is the market capitalization dividing line between micro-cap and small-cap companies. For the reasons stated above, we suggest that Rule 5121(a)(1)(A)(ii)c. be revised to read as follows in bold:

[5] See FINRA explanation of the calculation of "market capitalization" at https://www.finra.org/investors/insights/market-cap

[6] As explained by FINRA in https://www.finra.org/investors/insights/market-cap:

- mega-cap companies have a market value of $200 billion or more;
- large-cap companies have a market value between $10 billion and $200 billion;
- mid-cap companies have a market value between $2 billion and $10 billion;
- small-cap companies have a market value between $250 million and $2 billion; and
- micro-cap companies have a market value of less than $250 million.

~~as of the required filing date~~ **as of the date of commencement of sales of an offering with a conflict of interest**, the **issuer or the guarantor[7] of the** securities ~~are~~ offered ~~by an issuer that~~ has (i) been reporting under the Exchange Act for at least ~~one year~~ 180 days, (ii) is current in its reporting requirements, and (iii) its common equity securities have **a global market capitalization** ~~an aggregate market value~~ of at least ~~$300~~ **150** million.

3. FINRA Rules 5121(a)(2)(B) and (a)(3)(B) – QIU Written Agreement and Confirmation

If a QIU is required, proposed amendments in Rule 5121(a)(2)(B) provide, among other things, that a conflicted FINRA member must (i) engage or ensure a QIU is engaged before the commencement of sales, (ii) retain the QIU confirmation required by Rule 5121(a)(3)(B) and (iii) ensure there is a written agreement detailing the QIU services to be provided and any QIU compensation. Currently, QIU engagement, indemnity and any QIU compensation are generally reflected in the underwriting agreement, entered into on the date of commencement of sales (i.e., the pricing date), between the issuer and the underwriters. We suggest that Rules 5121(a)(2)(B) and (a)(3)(B) be clarified to allow the underwriting agreement entered into on the date of commencement of sales to be (i) the written agreement that includes the required provisions and satisfies Rule 5121(a)(2)(B) and (ii) the document that reflects the confirmation required by Rule 5121(a)(3)(B).

4. FINRA Rule 5121 Supplementary Material .01(a) – "Primarily Responsible for Managing the Public Offering"

Proposed Supplementary Material .01 to Rule 5121 notes:

> If two or more members that are primarily responsible for managing the public offering share responsibilities with regard to due diligence, each must be free of conflicts of interest, otherwise one of the conditions in paragraph (a)(1)(A)(i), (a)(1)(A)(ii)b. or (a)(1)(A)(ii)c. must be met in order for the conflicted member(s) to participate in the offering.

Interpretive questions are likely to continually arise with respect to the meaning of "share responsibilities with regard to due diligence" in the foregoing statement in connection with different offering fact patterns. All underwriters have due diligence

[7] Guarantors should be included in this provision in order to capture co-registrants such as finance subsidiaries issuing debt securities that are guaranteed by a public parent co-registrant.

obligations under the securities laws and participate at some level in due diligence. However, one and, sometimes two underwriters may actively manage the due diligence process, while the others are more likely to be passive participants in the process. For example, a passive bookrunning underwriter is generally labeled a "bookrunner" and often included in the list of underwriters on the top line on the cover of a prospectus regardless of the fact that it is not managing the due diligence process for the offering. For clarification purposes, we suggest that proposed supplementary material .01 be revised as follows in bold:

> If two or more members ~~**that**~~ are primarily responsible for managing **the due diligence responsibilities for** the public offering ~~**share responsibilities with regard to due diligence**~~, each must be free of conflicts of interest, otherwise one of the conditions in paragraph (a)(1)(A)(i), (a)(1)(A)(ii)b. or (a)(1)(A)(ii)c. must be met in order for the conflicted member(s) to participate in the offering.

5. FINRA Rule 5121 Supplementary Material .02 – Services and Compensation of a QIU

Proposed Supplementary Material .02 to Rule 5121 notes:

> A qualified independent underwriter is expected to participate in the preparation of the registration statement and perform due diligence if engaged prior to the initial filing of the registration statement. While a qualified independent underwriter that is retained after the registration statement has been filed cannot participate in the "preparation" of the registration statement as originally filed, it can conduct due diligence and require the issuer to amend the registration statement disclosures if necessary.

It is unclear whether "initial filing" in the foregoing provision references the initial confidential submission or initial public filing of the registration statement. Whether or not a conflict of interest exists and, therefore, whether or not a QIU is required in connection with a public offering is often not known until after the initial confidential submission of a registration statement. At this early stage of the offering process, due diligence is ongoing, the use of offering proceeds may still be under consideration by the issuer and the full underwriting syndicate may be unknown. Therefore, we suggest that the foregoing provision be clarified to reference the "initial public filing" rather than the "initial filing," as set forth below in bold:

> A qualified independent underwriter is expected to participate in the preparation of the registration statement and perform due diligence if engaged prior to the

initial **public** filing of the registration statement. While a qualified independent underwriter that is retained after the registration statement has been **publicly** filed cannot participate in the "preparation" of the registration statement as originally ~~**filed**~~ **submitted**, it can conduct due diligence and require the issuer to amend the registration statement disclosures if necessary.

6. FINRA Rule 5121 Supplementary Material .03 – Economic Interest in Offering Proceeds

We support FINRA's proposal in Rule 5121 Supplementary Material .03 clarifying that economic interests in offering proceeds for purposes of Rule 5121 do not include proceeds held on behalf of a FINRA member's customer. Because proceeds held on behalf of a customer may not always be held in "brokerage accounts," we suggest replacing this term with "customer accounts," which is a term used elsewhere in certain FINRA rules. Accordingly, we suggest the following changes in bold:

> This type of conflict of interest only applies if the participating member and its related affiliates and associated persons have an economic interest in the proceeds and does not include proceeds held in ~~**brokerage**~~ **customer** accounts on behalf of a member's customer.

C. Request for Reconsideration of Certain Prior Committee Comments

In its prior comment letter, dated August 7, 2023, the Committee requested that FINRA clarify:

- the "issuer" carve-out from the definition of "participating member" in Rule 5110(j)(12) and (15); and

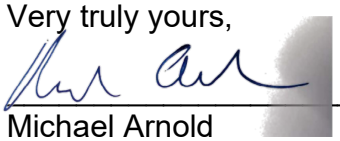
- the exceptions to underwriting compensation for securities acquired as a result of a conversion, stock split, pro-rata rights or similar offering of securities that would not otherwise be deemed to be underwriting compensation under Rule 5110.

We respectfully request FINRA's reconsideration of those comments for the reasons set forth the Committee's prior comment letter.

* * *

The Committee greatly appreciates the opportunity to provide its comments with respect the Notice and thanks the FINRA staff for its efforts to further increase efficiency and reduce unnecessary burdens on capital formation. Members of the Drafting Committee are available to meet and discuss these matters with the FINRA staff and to respond to any questions.

Very truly yours,



Michael Arnold
Federal Regulation of Securities Committee
ABA Business Law Section

Drafting Committee:
Gail S. Neely
Chair, Subcommittee on FINRA Corporate Financing Rules
Pallas A. Comnenos,
Vice Chair, Subcommittee on FINRA Corporate Financing Rules
Jennie Getsin
Peter W. LaVigne
Tracey Russell
Marta Talarek

sifma
Invested in America

March 20, 2025

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006-1506

Re: FINRA Regulatory Notice 24-17
FINRA Requests Comment on Proposed Changes to Corporate Financing Rules

Dear Ms. Mitchell:

Further to our comment letter dated August 7, 2023 in response to Regulatory Notice 23-09[1] ("Regulatory Notice 23-09 Comment Letter"), the Securities Industry and Financial Markets Association ("SIFMA" or "we")[2] appreciates the opportunity to respond to the request for comment by the Financial Industry Regulatory Authority, Inc. ("FINRA") in Regulatory Notice 24-17 ("Regulatory Notice 24-17"),[3] which (i) proposes certain substantive and clarifying changes to FINRA Rules 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements), 5121 (Public Offerings of Securities With Conflicts of Interest) and 5123 (Private Placements of Securities) (collectively, the "Corporate Financing Rules"), some of which are in response to comments FINRA received in response to Regulatory Notice 23-09, and (ii) requests comments addressing, among other considerations, whether the proposed amendments improve and clarify sections of FINRA Rule 5110, improve the operation of FINRA Rule 5121 and result in material economic impacts, including costs and benefits, for investors, issuers and members.

[1] *See* FINRA Regulatory Notice 23-09 (May 9, 2023), *available at* https://www.finra.org/rules-guidance/notices/23-09. SIFMA previously commented on Regulatory Notice 23-09. *See* letter from Joseph Corcoran to Jennifer Piorko Mitchell regarding FINRA Regulatory Notice 23-09 dated August 7, 2023, *available at* https://www.finra.org/sites/default/files/NoticeComment/SIFMA_8.7.23_23-09_Comment%20Letter.pdf (the "23-09 Comment Letter").

[2] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[3] *See* FINRA Regulatory Notice 24-17 (December 20, 2024), *available at* https://www.finra.org/rules-guidance/notices/24-17.

I. Introduction

SIFMA supports FINRA's ongoing efforts to review and consider changing its rules, including the Corporate Financing Rules, to increase efficiency and reduce unnecessary burdens on the capital raising process without compromising protections for investors and issuers. We acknowledge and appreciate the extensive effort FINRA has made over the years to meet with and hear from interested parties, including many of our members. Regulatory Notice 24-17 represents an important opportunity to continue to provide feedback on areas of regulation that may impede the capital formation process without the corresponding benefit of meaningful investor protection.

In this regard, SIFMA believes the modifications and clarifications of the Corporate Financing Rules detailed below are of significant importance to increasing the efficiency and effectiveness of FINRA's regulation of capital formation while continuing to promote transparency, establish important standards of conduct for its members, and maintain appropriate protections for investors and issuers.[4]

II. FINRA Rule 5110: Proposed New Supplementary Material .01(b)(23)

SIFMA supports the proposed FINRA Rule 5110 Supplementary Material .01(b)(23) safe harbor from the definition of underwriting compensation for equity securities that Participating Members acquire in connection with debt-for-equity exchange transactions,[5] and we agree that such exception would foster capital raising.

We believe, however, that the proposed conditions to satisfy the debt-for-equity exchange safe harbor, as currently drafted under proposed Supplementary Material .01(b)(23), would benefit from clarifying language that would align the requirements of the safe harbor with the typical structure of debt-for-equity exchange transactions. While there may be debt-for-equity exchanges that involve cash loans to issuers, we understand that many debt-for equity exchanges involve debt (e.g., loans, debt securities, or commercial paper) of a direct or indirect corporate shareholder of the issuer, which corporate shareholder transfers equity of the issuer in repayment of the debt of

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[4] Consistent with our comments set forth in the Regulatory Notice 23-09 Comment Letter, SIFMA supports FINRA's proposed treatment of non-convertible preferred securities acquired in a transaction related to a public offering at a fair price as underwriting compensation, but with no compensation value, similar to the treatment of non-exchangeable debt securities and derivative instruments under FINRA Rule 5110. SIFMA also supports the proposed expansion of the exemptions available under FINRA Rule 5123 to include offerings sold to investors meeting the categories of accredited investor for certain family offices and certain entities with assets under management in excess of $5 million, consistent with the SEC's treatment of those categories.

[5] A debt-for-equity exchange transaction is typically structured as follows: (1) A Participating Member or its affiliate either makes a loan to a corporate shareholder of the issuer or owns or acquires existing debt (e.g., loans, debt securities, commercial paper) of the corporate shareholder of the issuer, (2) the corporate shareholder then exchanges equity securities of the issuer (the "exchange shares") for the debt of the corporate shareholder held by the Participating Member or its affiliate, and (3) the Participating Member or its affiliate then sells the exchange shares in a registered public offering through one or more underwriters (which may include the Participating Member that engaged in the debt-for-equity exchange). Without the proposed Supplementary Material .01(b)(23) safe harbor the exchange shares received by the Participating Member or its affiliate may fall within the definition of "underwriting compensation" in FINRA Rule 5110.

the corporate shareholder held by the Participating Member[6] or its affiliate. Accordingly, in Regulatory Notice 24-17, where the proposed safe harbor provides that the debt-for-equity exchange shall be structured to provide favorable tax treatment and economic benefits to issuer, this requirement should be expanded to provide that the transaction could be structured to provide such economic and tax benefits to a direct or indirect shareholder of the issuer.

In this regard, we respectfully request that FINRA considers the proposed changes to the conditions under which a Participating Member may rely on the debt-for-equity exchange safe harbor from the definition of underwriting compensation under proposed Supplementary Material .01(b)(23) set forth under **Exhibit A** hereto. We believe that the proposed changes to the text of the rule will provide greater clarity for issuers and members to which this safe harbor was meant to apply and would align the rule's requirements with the typical structure of debt-for-equity exchange transactions.

III. FINRA Rule 5121(a): Bona Fide Public Market Exception to the QIU Requirement

Under FINRA Rule 5121, a member may not participate in a public offering in which it has a conflict of interest unless (i) a qualified independent underwriter ("QIU") has participated in the offering or (ii) one of three conditions are met, including that the securities offered have a "bona fide public market."[7] "Bona fide public market" is defined to mean a market for a security of an issuer that has been reporting under the Securities Exchange Act of 1934, as amended (the "Exchange Act") for at least 90 days, is current in its reporting requirements, and whose securities are traded on a national securities exchange with an ADTV (as provided by SEC Regulation M)[8] of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million.[9] Regulatory Notice 24-17 notes that this "combination of conditions has created confusion and frequent interpretive questions regarding appropriate measurement periods, calculation methods and price points."

The proposed amendment to FINRA Rule 5121(a)(1)(A)(ii)(c) would replace the "bona fide public market" exception to the QIU requirement with a standard that requires the issuer to (i) have been reporting under the Exchange Act for ***one year***; (ii) be current in its reporting requirements; and (iii) have common equity securities in aggregate market value of ***at least $300 million*** (the

[6] For the avoidance of doubt, the debt is often held by an affiliate of the FINRA member, which affiliate would be captured in the definition of Participating Member.

[7] FINRA Rule 5121(a).

[8] Regulation M defines ADTV to mean "the worldwide average daily trading volume during the two full calendar months immediately preceding, or any 60 consecutive calendar days ending within the 10 calendar days preceding, the filing of the registration statement; or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to § 230.415 of this chapter, two full calendar months immediately preceding, or any consecutive 60 calendar days ending within the 10 calendar days preceding, the determination of the offering price."

[9] FINRA Rule 5121(f)(3).

"Proposed Standard").[10] Regulatory Notice 24-17 states "FINRA believes that an issuer's capital value and amount of public information available for investors are more appropriate measurements for purposes of the exception than a bona fide market test that focuses on liquidity and trading volume." FINRA states in Regulatory Notice 24-17 that it anticipates that these changes would "exclude approximately half of all exchange listed issuers" from being able to rely on the exception from the QIU requirement under the Proposed Standard but will ensure the issuer is followed to a meaningful degree by investors and the analyst community. The potential collateral consequences associated with this heightened standard include a substantial increase in circumstances requiring a FINRA filing and a substantial increase in the corresponding costs for the issuers and Participating Members, and potentially delay the capital formation process.

The Proposed Standard effectively raises an issuer's reporting requirements from 90 days to one year and doubles the market value of equity securities that the issuer must have for a Participating Member to rely on this exception. As a result, there will be an increased number of issuers that will not be able to satisfy the Proposed Standard and, absent any other available exception, the issuer will need to engage a Participating Member to serve as a QIU. Under FINRA Rule 5121, the participation of a QIU eliminates any FINRA filing exemption, requiring the payment of the FINRA filing fee, which is expected to increase from a maximum of $225,000 to $1,125,000,[11] and outside counsel fees would likely increase due to the additional time associated with the comment and review process associated with a FINRA filing.

In addition, engaging a Participating Member to serve as QIU will require additional time, especially if a conflict of interest is identified later in the deal process. In accordance with FINRA Rule 5121 and the proposed amendments set forth in Regulatory Notice 24-17, there must be sufficient time for (i) the conflicted member and the QIU to enter into a separate agreement that details the services to be provided by the QIU, (ii) the issuer and syndicate to update the deal documents to disclose the conflicting member and the participation of the QIU, and (iii) the QIU to have "appropriate time to complete its due diligence [on the issuer] prior to the commencement of sales",[12] which, individually or in the aggregate, may delay deal timing.[13] Moreover, it may be difficult for the issuer and Participating Members to satisfy these timing requirements in public offerings with compressed timelines, such as block trades. Therefore, introducing the heightened criteria associated with the Proposed Standard may have an unintended consequence of deterring

[10] Regulatory Notice 24-17 at 6.

[11] See Proposed Rule Change to Adjust FINRA Fees to Provide Sustainable Funding for FINRA's Regulatory Mission, SR-FINRA-2024-19, available at: https://www.finra.org/sites/default/files/2024-11/sr-finra-2024-019.pdf.

[12] *See* Attachment A to Regulatory Notice 24-17 at 21.

[13] This potential delay in deal timing may be compounded by the issuer's ability to omit the names of the underwriters from its initial draft registration statement filing with the SEC, which, in turn, may delay the FINRA's corresponding review of the public offering. *See* Division of Corporation Finance of the Securities and Exchange Commission, *Enhanced Accommodations for Issuers Submitting Draft Registration Statements*, March 3, 2025, available at: https://www.sec.gov/newsroom/whats-new/draft-registration-statement-processing-procedures-expanded.

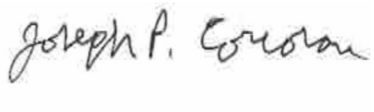
capital formation when reduced but equally effective standards can still achieve FINRA's goals of rule clarity, sufficient public information regarding the issuer, and investor protection generally.

SIFMA therefore respectfully requests that FINRA considers the comments to the Proposed Standard under FINRA Rule 5121(a)(1)(A)(ii)(c) set forth as **Exhibit B** hereto, requiring the issuer to have: (i) 180 days of reporting history that is current and an aggregate market value in common equity of $150 million; or (ii) 90 days of reporting history that is current and an aggregate market value in common equity of $200 million. We believe that these requirements would provide additional flexibility to satisfy this QIU exception while achieving FINRA's objectives of rule clarity and ensuring that investors are provided sufficient information regarding the issuer. With respect to condition (i) above, a 180-day reporting period (as opposed to one year under the Proposed Standard) would cover two reporting cycles and provide sufficient information to investors. Issuers that are unable to meet the 180-day reporting history requirement may otherwise qualify for an exception with 90 days of reporting history and an aggregate market value of $200 million, maintaining the reporting requirements under the "bona fide public market" definition in the current FINRA Rule 5121, but increasing the capital value to align with FINRA's reasoning that an increased capital value would "ensure that the company is followed to a meaningful degree by investors and the analyst community."[14]

***

SIFMA appreciates this opportunity to comment on Regulatory Notice 24-17 and thanks FINRA in advance for its consideration of this submission. SIFMA would be pleased to discuss any of these points further and provide additional information that would be helpful. Please do not hesitate to contact the undersigned or SIFMA's outside counsel, Jennifer Morton of Allen Overy Shearman Sterling US LLP, at (212) 848-5187.

Sincerely,



Joseph Corcoran
Managing Director and Associate General Counsel
SIFMA

cc: Robert W. Cook, President and Chief Executive Officer, FINRA
Robert L.D. Colby, Chief Legal Officer, FINRA
Gabriela Aguero, Senior Vice President, Corporate Financing, FINR

[14] Regulatory Notice 24-17 at 6.

EXHIBIT A

FINRA Rule 5110 Supplementary Material .01(b)(23)

Below is the text of proposed Supplementary Material .01(b)(23) under FINRA Rule 5110. Proposed new language is bolded and blue; proposed deletions are in strikethrough and red.

Supplementary Material

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(23) equity securities acquired by a ~~lender affiliated with a~~ participating member, **as defined in this Rule**, through a debt-for-equity exchange ~~that is sold by its affiliated member~~, if:

(A) the debt-for-equity exchange ~~was~~ **is** structured to provide economic and tax benefits to the issuer **of the equity securities or a shareholder of the issuer** and not **to** the ~~lender or affiliated member~~ **participating member**, except for the compensation in subparagraph (D) of this Supplementary Material .01(b)(23);

(B) ~~the affiliated member subsequently offered~~ all of the equity securities acquired by the **participating member are offered by the participating member or other member firms** ~~lender~~ in an offering following **or concurrent with** the debt-for-equity exchange;

(C) the terms negotiated in connection with the debt-for-equity exchange and the subsequent **or concurrent** equity offering were determined through arms' length negotiations based on the market price**s** of the **debt and** equity exchanged, subject to the compensation in subparagraph (D) of this Supplementary Material .01(b)(23);

(D) the ~~affiliated~~ **participating** member negotiated customary **underwriting** compensation **received or to be received by participating members in connection with a subsequent or concurrent** ~~for an~~ equity public offering **related to the debt-for-equity exchange**; and

(E) the equity public offering ~~was~~ **is** structured as a firm commitment offering.

EXHIBIT B

FINRA Rule 5121(a)(1)(A)(ii)

Below is the text of proposed FINRA Rule 5121(a)(1)(A)(ii). Proposed new language is bolded and blue; proposed deletions are in strikethrough and red.

(A) No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraph (i) or (ii).

(i) A qualified independent underwriter has participated in the offering and meets the requirements of paragraph (a)(3) of this Rule; or

(ii) The offering can meet one of the following conditions:

a. each member(s) that is primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirements of paragraph (a)(3)(A)(vi);

b. as of the required filing date, the securities offered are investment grade rated or are securities in the same series that have equal rights and obligations as investment grade rated securities; or

c. as of the required filing date, the securities are offered by an issuer that has **either**:

(i) been reporting under the Exchange Act for at least ~~one year~~ **180 days**, ~~(ii)~~ is current in its reporting requirements, and ~~(iii)~~ its common equity securities have an aggregate market value of at least $150 million**; or**

(ii) been reporting under the Exchange Act for at least 90 days, is current in its reporting requirements, and its common equity securities have an aggregate market value of at least $200 million.

March 20, 2025

Jennifer Piorko Mithcell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, D.C. 20006
pubcom@finra.org

RE: Regulatory Notice 24-17 (Notice)

Dear Ms. Mitchell:

The Institute for Portfolio Alternatives (IPA) appreciates FINRA's efforts to improve and clarify its rules governing capital formation, as represented most recently by the Notice. The IPA represents sponsors and distributors of alternative investments, including net asset value (NAV) REITs and business development companies (BDC), lifecycle REITs and BDCs (REITs and BDCs that are not continuously offered but do maintain share repurchase programs),[1] interval funds, tender offer funds and regulated distributors of private placement securities.

EXECUTIVE SUMMARY

The IPA supports the amendments proposed in the Notice, particularly the proposed amendments to Rule 5110 and Rule 5123. We do, however, have the following additional suggestions:

- We recommend that the proposed new Supplementary Material .05 to Rule 5110, concerning capitalization transactions, be clarified to:
    - establish a self-operating safe harbor, rather than one subject to FINRA staff discretion;
    - provide that a capitalization transaction occurring before the issuer has material assets will be deemed to occur at or above NAV; and
    - provide the safe harbor for any capitalization transaction that meets the conditions of the Supplementary Material at any time during the life of the nonlisted REIT or BDC, not only capitalization transactions made before or at the time of the initial offering.

[1] While no lifecycle REITs or BDCs are currently being offered, many are still in an operational phase.

- We recommend that FINRA consider improvements to the operation of Rule 5110 and Rule 2310.
- We recommend that FINRA conduct a retrospective review of Rule 2310, to address the anachronistic and impractical features of that rule.
- We respectfully request that FINRA reconsider the dramatic increase in FINRA filing fees related to its public offering program, particularly as they apply to nonlisted REITs and BDCs.

1. The IPA Supports Proposed Supplementary Material .05

The IPA supports proposed Supplementary Material .05 to Rule 5110, which would provide a safe harbor for a transaction to capitalize a nonlisted REIT or BDC.[2] Much like the sponsors of registered investment companies, nonlisted REIT and BDC sponsors often inject capital so that the REIT or BDC can acquire assets. We agree with FINRA that the shares received by the sponsor in these capitalization transactions should not be treated as "underwriting compensation" when they meet the conditions of the Supplementary Material.

The Supplementary Material would provide a safe harbor from underwriting compensation for a capitalization transaction (1) that is disclosed in the prospectus, (2) when the securities "are valued and priced on a net asset value or NAV basis," (3) when the offering is subject to Rule 2310, and (4) when there is no economic disposition of the acquired securities for 180 days following commencement of sales.

The Supplementary Material would clarify that capitalization transactions meeting these conditions would not constitute underwriting compensation under Rule 5110. For this reason, the IPA supports the Supplementary Material. We do, however, have three recommendations to further clarify the safe harbor.

A. The Safe Harbor Should be Self-Operating

First, the Supplementary Material would provide that FINRA "may" exclude securities acquired in certain capitalization transactions. The proposed safe harbor would not foster capital formation in an efficient manner if the FINRA staff would have to approve every invocation of the safe harbor by a nonlisted REIT or BDC.

We recommend that the safe harbor be self-operating, to ensure that it will function most efficiently. We thus recommend the following changes to the introduction of the Supplementary Material:

[2] The Notice says that capitalization transactions covered by the Supplementary Material "are common in unlisted REIT and DPP offerings." Nonlisted BDCs typically are structured as "direct participation programs," as defined in Rule 2310(a)(4).

> Notwithstanding paragraph (j)(22) of this Rule, [FINRA may exclude] securities acquired by a participating member in the issuer or an affiliated entity, in connection with the investment of cash to capitalize a direct participation program or a real estate investment trust, as defined in Rule 2231(d), are excluded . . .

Our suggested change would advance the purpose of the Supplementary Material to foster capital formation by removing unnecessary impediments to legitimate capitalization transactions.

B. A NAV Determination Should not be Necessary in connection with a Seed Capital Transaction

Second, the Supplementary Material would require that the securities acquired in the capitalization be "valued and priced on a net asset value or NAV basis." The language could be read to require the sponsor to implement the procedures called for under Rule 2231 to establish a net asset value. Such an appraisal should not be required for an initial capitalization transaction as it is the initial capitalization that effectively sets the net asset value. Prior to the issuer having material assets, the shares are worth no more than what the sponsor pays for them.

We suggest the following clarification:

> (b) the securities offered to the public and the securities acquired in the capitalization transaction are valued and priced on a net asset value or NAV basis; provided that, with respect to a seed capital investment before the issuer has material assets, the securities acquired in the capitalization transaction shall be conclusively deemed to have been priced on an NAV basis.

C. The Safe Harbor Should Be Available After the Initial Offering

Third, the safe harbor would apply to any "seed capital investment or a comparable form of capitalization." The title of the Supplementary Material is "Seed Capital Investments" and the Notice refers to "investments by participating members in anticipation of, or concurrently with, a public offering." It is not uncommon for capitalization transactions to occur during the life of a continuously offered nonlisted REIT or BDC. These transactions may be necessary, for example, if the nonlisted REIT or BDC intends to acquire additional assets but is subject to legal, policy or practical limitations on its ability to do so from existing capital.

There is no reason for these capitalization transactions to be counted as underwriting compensation if they meet the conditions of the Supplementary Material – that the transaction is disclosed in the prospectus, the purchase price occurs at NAV, the

offering complies with Rule 2310, and there is no economic disposition of the securities for 180 days.

We therefore recommend that FINRA change the title of the Supplementary Material to "Capital Investments," amend paragraph (a) as follows, and make clear in the final regulatory notice that that the safe harbor would be available to any capitalization transaction that meets the safe harbor's conditions, including one occurring after the initial offering:

> (a) the acquisition of securities is disclosed in the issuer's prospectus as a [seed] capital investment or a comparable form of capitalization.

2. The IPA Recommends Improvement in the Operation of Rule 5110 and Rule 2310

In addition to the proposed amendments, FINRA has "implemented operational improvements in response to comments from members that raise capital" in exempt offerings. The IPA continues to recommend that FINRA adopt operational improvements in its review of registered offerings, too.

In particular, we recommend that the Corporate Financing Department streamline its process for reviewing nonlisted REIT and BDC filings under Rule 5110 and Rule 2310. For example, outside counsel to sponsors must submit an itemized list of all possible sources of underwriting compensation, including sales charges, ongoing servicing fees, reimbursement of travel and entertainment expenses, payment of compensation to the registered representatives of the dealer-manager who act as wholesalers, gifts and expenses associated with hosting and attending broker-dealer and investment adviser conferences and events.

With the advent of the NAV REIT and BDC, the total amount of compensation from these items rarely exceeds the caps on underwriting compensation. NAV REITs and BDCs typically provide in their charter that if the total underwriting compensation paid ever equals ten percent of the gross proceeds of the primary portion of the offering, all shares with respect to which an ongoing stockholder servicing fee is charged will convert to a class of no-load shares for which no such fee is charged.

In order to simplify the Department's review of these offerings and to reduce filing costs to sponsors, we respectfully recommend that, in lieu of the requirement that sponsors provided an itemized list of underwriting compensation sources, the Department permit sponsors of NAV REITs and BDCs simply to provide a statement that (1) acknowledges the existence of the underwriting caps in Rule 5110 and Rule 2310, (2) states that the REIT or BDC has a charter provision designed to ensure that it

does not breach those caps, and (3) states that the sponsor will promptly notify the Department if the caps are breached.[3]

3. The IPA Recommends a Retrospective Review of Rule 2310

FINRA has not taken a comprehensive look at Rule 2310 in almost two decades, and the rule is out of date.[4] For example, Rule 2310(b)(2) imposes a suitability standard on the recommendation of a direct participation program (DPP) without any recognition of the Securities and Exchange Commission's adoption of Regulation Best Interest. Moreover, as we have previously commented, the prohibition in Rule 2310(b)(2)(C) of any execution of a DPP transaction in discretionary accounts without prior written customer approval is unnecessary and unworkable, particularly when the FINRA member only executes, and does not recommend, the transaction.[5] The FINRA staff's interpretation of this provision, to cover members who merely execute a transaction recommended by a registered investment adviser, raises costs to the investor by preventing "turnkey" platforms such as those offered by Charles Schwab, TD Ameritrade, NFS, and Pershing, from acting solely as the broker-dealer of record to execute a DPP transaction on behalf of registered investment advisers.

These are only two examples of the anachronistic features of Rule 2310. The IPA respectfully urges FINRA to conduct a retrospective review of that rule, to modernize its provisions and to ensure that the rule does not unnecessarily impede capital formation.[6]

4. The IPA Requests Reconsideration of the Dramatic Increase in Filing Fees

FINRA recently adopted an increase in many of its fees, including the filing fee related to its public offering program.[7] FINRA members participating in the public offerings of nonlisted REITs and BDCs must file under Rule 5110 and Rule 2310 and therefore will be affected by FINRA's fee increase. This fee increase is typically reimbursed by the

[3] Our recommendation should not represent a significant departure from, and would resemble, the Department's limited review program.

[4] *See* https://www.finra.org/sites/default/files/RuleFiling/p015082.pdf (September28, 2005) (proposed amendments to the predecessor to Rule 2310).

[5] *See* IPA Letter to Jennifer Piorko Mitchell (August 7, 2023).

[6] *Cf.* Regulatory Notice 17-15 (April 12, 2017) (comprehensive proposal to amend Rule 5110).

[7] *See* https://www.finra.org/sites/default/files/2024-11/sr-finra-2024-019.pdf at 43. (Notice of effectiveness by the Securities and Exchange Commission) ("SEC Release"). FINRA also has adopted a filing fee for its private placement program under Rule 5122 and Rule 5123. *Id.* at 42.

nonlisted REIT and BDC conducting the public offering, and ultimately by its stockholders.

The maximum fee today for FINRA members participating in nonlisted REIT and BDC public offerings is $225,500. FINRA has adopted an almost five-fold increase in the fee, effective on July 1, 2025. On the date, FINRA will raise the maximum fee for offerings other than for Well-Known Seasoned Issuers to $1,125,000.[8]

We appreciate the fact that FINRA last increased its public offering program filing fee in 2012, and that a fee increase might be justified. Nevertheless, a five-fold increase in the fee seems excessive. Such a dramatic increase will encourage nonlisted REITs and BDCs to raise capital in private placements, outside of FINRA's regulation under Rule 5110 and Rule 2310. As FINRA may be aware, nonlisted REITs and BDCs increasingly are choosing to offer their shares through private placements rather than public registrations, partially due to increasing expenses associated with the public offering of their shares.[9] Because these expenses fall particularly hard on smaller REITs and BDCs, the five-fold increase in FINRA's filing fee could discourage competition.

For these reasons, we respectfully request that FINRA reconsider the dramatic increase in FINRA filing fees related to its public offering program, particularly as they apply to nonlisted REITs and BDCs.

Thank you for the opportunity to comment on the Notice. Please send questions about our comments to Jeff Evans, IPA's director of government affairs and policy, at jevans@ipa.com.

Sincerely,

Anya Coverman
President and CEO
Institute for Portfolio Alternatives

[8] For WKSI filers the maximum fee will increase over five years from $225,000 to $560,000. SEC Release at 44.

[9] See, e.g., "Ares Management Forsakes Public Nonlisted REIT Stock Sales" (CoStar), https://www.costar.com/article/44091416/ares-management-forsakes-public-nonlisted-reit-stock-sales.

ADISA
ALTERNATIVE & DIRECT INVESTMENT SECURITIES ASSOCIATION
Education ▲ Networking ▲ Advocacy

10401 North Meridian Street
Suite 202
Indianapolis, IN 46290

317.663.4180 main
317.815.0871 fax
866.353.8422 toll free

www.adisa.org

March 18, 2025

VIA E-MAIL (pubcom@finra.org)

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority, Inc.
1700 K Street, NW
Washington, DC 20006

Re: Regulatory Notice 24-17: Capital Formation

Dear Ms. Mitchell:

On behalf of the Alternative & Direct Investment Securities Association ("**ADISA**")[1], we are submitting this comment letter regarding the Regulatory Notice 24-17: Capital Formation (the "**Notice**") to the FINRA Corporate Financing Rules (the "**CF Rules**"). ADISA appreciates the opportunity to provide comments on behalf of its members.

ADISA believes that many of the proposed changes to the CF Rules will be beneficial to its members; however, ADISA has the following specific comments on the Notice.

Safe Harbors: Exclusions From Underwriting Compensation.

1. ***ADISA recommends that, in addition to those investments made concurrently with or in advance of the public offering, additional contributions of seed capital should not be considered underwriting compensation and should be included in the safe harbor exclusion, subject to the same conditions set forth in the proposed revision.***

ADISA commends FINRA for excluding from underwriting compensation seed capital investments made by affiliates of underwriters concurrently with or in advance of a public offering. FINRA has proposed this exclusion on the condition that:

[1] ADISA (Alternative & Direct Investment Securities Association), is the nation's largest trade association for the non-traded alternative investment space (i.e., retail vs. institutional). Through its 5,000 financial industry members (over 1,000 firms), ADISA reaches over 220,000 finance professionals, with sponsor members raising in excess of $200 billion annually, serving more than 1 million investors. ADISA is a non-profit organization (501(c)(6)), registered to lobby, and also has a related 501(c)(3) charitable non-profit (ADISA Foundation) assisting with scholarships and educational efforts.

- the seed capital investments are disclosed in the prospectus;
- the offering and the acquisitions are valued and priced based on net asset value;
- the offering is subject to the requirements of Rule 2310 (Direct Participation Programs); and
- the securities acquired are restricted for a period of 180 days following the commencement of sales.

These seed capital investments are typically required by state securities regulators pursuant to the North American Securities Administrators Association's Statement of Policy Regarding Real Estate Investment Trusts ("**NASAA REIT Guidelines**") in an amount equal to the lesser of 10% of the total net assets upon completion of the offering or $200,000, which amount is required to remain invested in the issuer but may be transferred to other affiliates.[2]

The explicit exclusion of these investments from underwriting compensation is welcome; however, ADISA urges FINRA to also include capital contributions after sales have commenced. While the exclusion from underwriting compensation is only for those investments made concurrently with or in advance of the public offering, the sponsor or an affiliate may determine to make additional contributions of capital following the effectiveness of the offering and after sales have commenced either because of an investment opportunity that exceeds currently available investment proceeds or for other business considerations, such as breaking escrow or requirements from selling group members in order to add the program to its platform. It does not appear that these additional investments would be included under the safe harbor provisions because they were not made concurrently with or in advance of the public offering.

2. ***ADISA recommends that the safe harbor restrictions fully align with the NASAA REIT Guidelines.***

The proposed restrictions on the sale of the securities acquired pursuant to the safe harbor provisions are different than those contained in the NASAA REIT Guidelines because the proposed restrictions do not provide that those securities may be transferred to an affiliate of the sponsor which is allowable pursuant to Section II.A.2. of the NASAA REIT Guidelines. ADISA believes that there should be consistency between the FINRA safe harbor and the NASAA REIT Guidelines regarding the ability to transfer those securities to affiliates. In order to effectuate that consistency, ADISA proposes that the following language be added to the end of .05(d):

"; provided, however, the securities acquired and excluded may be transferred to other affiliated entities, which transfer would not be deemed to constitute an economic disposition of the securities during the 180 day period."

3. ***ADISA recommends that for the purpose of calculating the lockup restriction period, FINRA use the definitive date of effectiveness of the offering as a measurement rather than commencement of sales.***

[2] NASAA REIT Guidelines, Section II.A.

ADISA believes that "commencement of sales" is not a date certain and can be difficult to pinpoint for purposes of measuring the lockup restriction period whereas the date of effectiveness is readily available to the public. Many of ADISA member's offerings are "best efforts" and there can be a significant time lag between the date of effectiveness and the date of first sale (or the breaking of escrow). If the lockup restrictions do not begin until the commencement of sales, is that the date selling agreements are entered into, the date that the first subscription agreement is received, the date that escrow is broken, or some other date? The date of effectiveness is a date certain that is publicly available on the SEC's website and would provide clarity to all participants in the offering rather than a date that will be more difficult to determine and harder yet to notify the holders of the securities subject to such restrictions.

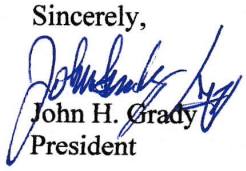
Proposed Amendments to Rule 5123

1. ***ADISA urges FINRA to include additional categories of accredited investors to the exemptions for filing private offerings as the definition of accredited investor continues to evolve.***

ADISA agrees with and appreciates FINRA adding the two additional categories of accredited investor contained in Rule 501(a)(9) and (12) pursuant to Regulation D to the exemption for filing private placement offering documents and retail communications pursuant to FINRA Rule 5123. ADISA believes that FINRA should continue to review and consider adding further categories of investors pursuant to which the exemption for filing would apply as the definition of accredited investor continues to evolve pursuant to future SEC rulemaking or legislation.

ADISA appreciates the opportunity to provide input. We would be happy to discuss our concerns further and to continue to assist FINRA in creating appropriate protections for investors.

Sincerely,



John H. Grady
President

Drafting Committee:

Deborah S. Froling
Catherine Bowman

From: [REDACTED]
To: Comments, Public
Subject: Response to FINRA Regulatory Notice 24-12; Proposed Changes to Corporate Finance Rules
Date: Tuesday, December 24, 2024 11:42:22 AM

Response to Request for Comment Proposed Changes to Corporate Finance Rules, FINRA Regulatory Notice 24-12

Secretary Jennifer Piorko Mitchell:

The Proposed Amendments to Rule 5123 should exempt all Accredited Investors as defined in Securities Act Rule 501(a). Specifically, it should exempt offerings to insiders of issuers (a)(4); natural persons with the stated net worth (a)(5) and stated income (a)(6); credentialed persons (a)(10); knowledgeable persons defined in the Investment Company Act of 1940; entities comprised of Accredited Investors (a)(8) and clients of family offices (a)(13).

This would be consistent with the legislative intent in adopting the definition of Accredited Investor in the first place.

Also, Rule 5123 should be simplified so that compliance officers or inexperienced securities lawyers do not get confused by the fact that some, but not all, accredited investors are included in the carve out. It should not be necessary for a broker-dealer to have to consult an expensive attorney simply to discern whether or not the 5123 filing is required.

Also, Rule 5123 should be amended to allow a safe harbor for a broker-dealer who has a written agreement with another BD to submit on its behalf the required 5123 filing. This would save time and money in having to follow-up to ensure that the BD which has agreed to do the filing has actually met its obligations.

Thank you.

Respectfully submitted 12/24/24.

Daniel H. Kolber
CEO/General Counsel
Intellivest Securities, Inc.
Riverdale, GA
Dkolber@Intellivestsecurities.com
678-595-9746

University of Pittsburgh
School of Law

3900 Forbes Avenue
Pittsburgh, PA 15260
412-648-1490

March 20, 2025

Via email
Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006

RE: University of Pittsburgh Securities Arbitration Clinic response to the "Proposed Changes to Corporate Financing Rules" request for comment Regulatory Notice 24-17

By: Professor Alice. L. Stewart*, Professor Rachael T. Shaw*, Amit Levin*, and Krina Patel*

Table of Contents

* Director of Legal Clinics and Associate Professor of Law; Director of the University of Pittsburgh Securities Arbitration Clinic and Low-Income Taxpayer Clinic.
* Staff Attorney/Adjunct Professor of Law.
* J.D. Candidate, University of Pittsburgh School of Law, Class of 2026.
* J.D. Candidate, University of Pittsburgh School of Law, Class of 2026.

Introduction

Dear Secretary Jennifer Piorko Mitchell:

The University of Pittsburgh Securities Arbitration Clinic (the "Clinic") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") proposed amendments to the corporate financing rules. The Clinic, a University of Pittsburgh curricular offering, provides legal representation to investors with limited resources, often advocating for people whose claims represent much of their life savings. The Clinic offers the following commentary on the proposed initiative.

Clinic's Statement

The proposed amendments to Rules 5110, 5121, and 5123 will bring about several economic impacts– both negative and positive– for investors with limited resources. The Clinic urges FINRA to consider the impact the changes will have on our clients and other potential investors with limited resources and small investments.

Potential Benefits for Small Investors

Rule 5110 regulates underwriting arrangements to prevent unfair compensation practices in public offerings. The goal of Rule 5110 is to ensure transparency and protect investors from excessive fees. The amendments to Rule 5110 introduce important clarifications to underwriting compensation rules, making it easier for investors to assess whether firms are acting fairly. Historically, underwriting fees have constituted the largest direct expense in initial public

offerings– averaging between 4% and 7% of gross IPO proceeds.[1] These substantial costs can lead to inflated pricing, which may disproportionately affect small investors. By amending the valuation method, FINRA aims to create a more predictable and transparent process, thus ensuring fair pricing for all investors and reducing opportunities for manipulation.

For small investors, this increased transparency means they are less likely to unknowingly invest in offerings burdened with excessive underwriting fees. With clearer and more efficient valuation methods in place, investors can make more informed decisions. Furthermore, small investors– who may lack the resources to conduct extensive due diligence– will benefit from the system, which minimizes hidden costs and increases transparency.

Secondly, the amendments to Rule 5110 establish additional safe harbors, where underwriters do not need to file documents outlining the terms of the underwriting agreement with FINRA. Since underwriters typically receive a commission based on the total value of securities sold, reducing filing costs leads to a lower IPO price. With the additional safe harbors, more underwriters are exempt from the filing requirements, which in turn leads to reduced filing fees. Small investors are likely to benefit from additional safe harbors as IPO prices are reduced. Further, because of the additional safe harbors, smaller investors would be able to access more diverse investment opportunities without facing high costs. As the barriers to entry decrease, the overall inclusivity of the investment landscape will improve– especially for investors with limited resources.

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[1] *See Considering an IPO? First, Understand the Costs*, PwC, https://www.pwc.com/us/en/services/consulting/deals/library/cost-of-an-ipo.html (last visited Mar. 20, 2025).

Rule 5121 requires prominent disclosure when a conflict of interest exists. Under Rule 5121, a Qualified Independent Underwriter (QIU) is required when a conflict of interest exists. Rule 5121(a)(1) outlines three scenarios when a QIU is not needed for conflicts of interest. Rule 5121(a)(1)(B) states that a QIU is not needed when "the securities offered have a bona fide public market." What constitutes a "bona fide public market" has created "confusion and frequent interpretive questions."[2] In response, FINRA proposes to amend the "bona fide" requirement with a more comprehensive standard.

The new standard establishes that a QIU is not required when (1) the issuer has been a publicly reporting company for at least one year; (2) the issuer is up to date on all required financial filings; and (3) the issuer has at least $300 million in common stock market value. The new amendment ensures that more information is available to investors concerning conflicted securities. The new standard reduces ambiguity and ensures that only issuers with a well-established market presence and transparent financial disclosures are exempt.

Additionally, FINRA proposes new requirements for QIUs under Rule 5121. The first requirement is that if a QIU is needed, the conflicted parties and the QIU must sign a written agreement outlining the QIU's roles, responsibilities, and compensation. The second requirement is that the QIU must confirm that they participated in the preparation of all registration materials and filings. These measures enhance QIU due diligence and protect small investors from potential conflicts of interest. By ensuring that an independent party is overseeing offerings

[2] *See* FINRA, Regulatory Notice 24-17 FINRA Requests Comment on Proposed Changes to Corporate Financing Rules, December 20, 2024, https://www.finra.org/rules-guidance/notices/24-17.

where conflicts exist, investors are better safeguarded against misleading or incomplete disclosures.

Lastly, Rule 5123 requires firms to file disclosure documents with FINRA when they sell private placement securities. The proposed amendments would reduce filing requirements for certain accredited investors, which, as a result, would lower the cost of the offering. Issuers often pass their regulatory expenses onto investors in the form of higher share prices, so by reducing the costs associated with filing, share prices should decrease. In turn, small investors would benefit as they would have access to a more diverse range of investment opportunities at more affordable prices.

Potential Risks for Small Investors

Although the proposed amendments to Rules 5110, 5121, and 5123 aim to enhance transparency and investor protection in public offerings and private placements, these changes may inadvertently introduce risks for small investors. These risks include diminished oversight of private placements, increased compliance costs passed onto smaller investors, potential for information overload due to expanded disclosure requirements, and heightened susceptibility to market manipulation.

One substantial risk posed by the proposed amendments is the potential for weaker oversight of private placements. The proposed amendment to Rule 5123 expands the definition of the "accredited investor," thereby allowing a greater number of individuals to qualify under this designation. This expansion reduces the number of private placement filings required, which may result in a corresponding decline in transparency and increased exposure to risk for small investors. If small investors engage in private placements through pooled investment vehicles,

the reduced filing requirement may obscure critical information, thereby increasing their vulnerability. Furthermore, the proposed changes exacerbate the already limited access to private placements for small investors.[3] Given the SEC's existing restrictions on who may participate in private placements, small investors are largely excluded from these investment opportunities.[4] By reducing the number of required filings, small investors will face even greater challenges in accessing reliable information about private placements. Sophisticated investors, on the other hand, can leverage their relationships with large investment firms to identify and participate in lucrative private placement opportunities. Small investors, lacking these resources, must rely on the limited expertise of their broker dealers.[5] With less information available, broker dealers may be disinclined to recommend private placements due to the unknown risk, further compounding the information and investment asymmetry that disadvantages small investors.

Another critical concern is the likelihood that increased compliance costs for member firms will be transferred over to small investors. The proposed amendment to Rule 5110, which changes the valuation method from a bona fide public market standard to one based on closing market price, introduces a clearer standard for determining when underwriting compensation must be filed with FINRA. However, this change will increase the volume of required filings, thereby imposing higher administrative and filing costs on firms. These increased expenses are likely to be passed on to investors, particularly those who depend on small and medium-sized

[3] See FINRA, Private Placements Regulatory Obligations and Related Considerations, https://www.finra.org/rules-guidance/guidance/reports/2024-finra-annual-regulatory-oversight-report/private-placements.
[4] Private Placements - Rule 506(b), U.S. Securities and Exchange Commission (Nov. 14, 2024), https://www.sec.gov/resources-small-businesses/exempt-offerings/private-placements-rule-506b#:~:text=securities%20may%20not%20be%20sold,merits%20and%20risks%20of%20the.
[5] See FINRA, Firm Guidance – Private Placement Filings, https://www.finra.org/rules-guidance/key-topics/private-placements/filing-guidance.

enterprises for investment services.[6] The proposed amendments to Rule 5121 will further elevate compliance costs by requiring firms to conduct comprehensive reassessments of public offerings involving conflicts of interests and QIUs. Similarly, firms must evaluate whether investors meet the expanded accredited investor definition under Rule 5123. Empirical evidence suggests that increased regulatory compliance costs are typically borne by end clients. For instance, a 2023 report by the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness found that over one-third of surveyed businesses raised their costs in response to expanded financial regulations, restricting their ability to offer services and make further investments.[7] Although the study focused on the banking sector, a similar dynamic is expected to manifest in investment firms, resulting in higher fees and reduced returns for small investors.

A further risk for small investors arising from the proposed amendments is the potential for information overload. The increased disclosure requirements under Rule 5121, particularly the obligation for additional confirmations by a QIU, may create an illusion of enhanced security and reliability. Small investors might mistakenly believe that offerings involving QIU confirmations are inherently safer or less risky than those without, despite both categories carrying comparable levels of risk. The complexity and volume of these disclosures could overwhelm less experienced investors, leading to suboptimal investment decisions. This concern is especially pertinent given the existing disparity in financial literacy between retail investors and institutional market participants.

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[6] See SEC Office of Investor Education and Advocacy, Investor Bulletin How Fees and Expenses Affect Your Investment Portfolio, http://sec.gov/investor/alerts/ib_fees_expenses.pdf.
[7] How Business Views Financial Challenges, U.S. Chamber of Commerce (Oct. 25, 2023), https://www.uschamber.com/finance/how-business-views-financial-challenges.

Finally, the proposed changes to Rule 5110, which substitutes the bona fide public market standard with a closing market valuation method to determine underwriting compensation, raise concerns about potential market manipulation. By allowing firms to rely on closing market prices, the amendments create an opportunity for price manipulation around key market dates. Firms could deliberately engage in practices that cause short-term price fluctuations, thereby misrepresenting the true value of underwriting compensation. Such manipulation undermines market integrity and disproportionately impacts small investors who lack the resources to detect and interpret these pricing anomalies. This regulatory change, if exploited, could further erode trust in the fairness and transparency of financial markets, placing small investors at an even greater disadvantage.

Conclusion

Thank you for this opportunity to comment on Regulatory Notice 24-17 - Proposed Changes to the Corporate Financing Rules. The commentary above highlights the potential benefits and risks that our Clinic at the University of Pittsburgh School of Law foresees for our current and prospective clients, as well as for small investors in general.

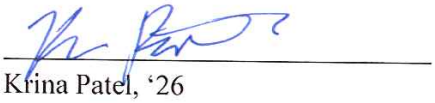
[Signatures next page]

Respectfully Submitted,

Alice L. Stewart
Associate Professor of Law, Legal Clinics
Director of Legal Clinics

Rachael T. Shaw
Staff Attorney/Adjunct Professor Law

Amit Levin, '26
Certified Student Attorney, Securities Arbitration Clinic



Krina Patel, '26
Certified Student Attorney, Securities Arbitration Clinic

EXHIBIT 5

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

* * * * *

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5110. Corporate Financing Rule — Underwriting Terms and Arrangements

(a) Requirements for Public Offerings

(1) through (3) No Change.

(4) Documents and Information Required to be Filed

(A) No Change.

(B) Any member filing documents with FINRA pursuant to paragraph (a)(4)(A) must file the following information with respect to the offering in FINRA's Public Offering System:

(i) through (iii) No Change.

(iv) a description of any securities of the issuer acquired and beneficially owned by any participating member during the review period, provided that:

a. non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering must be filed and also accompanied by a representation that a registered principal or senior manager of the participating member has determined if the transaction was or will be entered into at a fair price;

b. non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments need not be filed if acquired in a transaction that is unrelated to the public offering; and

c. securities if acquired in accordance with Supplementary Material .01(b) need not be filed.

(v) through (vi) No Change.

(C) through (E) No Change.

(b) No Change.

(c) Valuation of Underwriting Compensation

(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security

A participating member may not receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:

(A) the security received or the security underlying the warrant or convertible security received is identical to the security offered to the public[or to a security with a bona fide public market]; or

(B) the security can be accurately valued[,] using any method in this paragraph (c)[as required by paragraph (g)(1) of this Rule].

(2) Valuation of Non-Convertible Securities

Non-convertible securities received as underwriting compensation will have a compensation value based on:

(A) the difference between:

(i) either the closing market price [per]of the security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b) on the date of acquisition, or[, if no bona fide public market exists for the security,] the public offering price per security; and

(ii) the per security cost;

(B) through (D) No Change.

(3) Valuation of Convertible Securities

Options, warrants or convertible securities ("warrants") shall have a compensation value based on the following formula:

(A) No Change.

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

(i) the closing market price [per]of the convertible security, or the common stock or other security underlying the convertible security traded on a U.S. registered national securities exchange or a designated offshore securities market as defined under Securities Act Rule 902(b) on the date of acquisition[, where a bona fide public market exists for the security]; or

(ii) the public offering price per security;

(C) through (H) No Change.

(4) No Change.

(5) Valuation of Securities Acquired in Connection with [a] Fair Price Non-Convertible, [or]Non-Exchangeable Debt or Preferred Securities and [or] Derivative Instruments

Any non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments acquired or entered into at a "fair price" as defined in Supplementary Material .06(b) and underwriting compensation received in or receivable in the settlement, exercise or other terms of such non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the non-convertible, [or] non-exchangeable debt or preferred securities and derivative instruments [is] are not at a fair price, compensation will be calculated pursuant to this paragraph (c) or based on the difference between the fair price and the actual price.

(d) No Change.

(e) Lock-Up Restriction on Securities

(1) No Change.

(2) Exceptions to Lock-Up Restriction

Notwithstanding paragraph (e)(1):

(A) the lock-up restriction will not apply:

(i) through (iii) No Change.

(iv) to a non-convertible [or] and non-exchangeable debt or preferred security acquired in a transaction related to the public offering;

(v) through (ix) No Change.

(B) No Change.

(f) No Change.

(g) Unreasonable Terms and Arrangements

Without limiting the requirements of paragraph (a)(1)(A) of this Rule, the following terms and arrangements are prohibited:

(1) through (4) No Change.

(5) any underwriting compensation in connection with a public offering that is not completed according to the terms of an agreement entered into by an issuer and a participating member, except

(A) No Change.

(B) a termination fee, a tail fee or a right of first refusal, as set forth in a written agreement entered into by an issuer and a participating member, provided that:

(i) No Change.

(ii) an issuer's exercise of its right of "termination for cause" eliminates any obligations with respect to the payment of any termination fee, tail fee or provision of any right of first refusal;

(iii) the amount of any termination fee or tail fee must be reasonable in relation to the underwriting services contemplated in the agreement and any fees arising from underwriting services provided under a right of first refusal must be customary for those types of services; and

(iv) the issuer shall not be responsible for paying the termination fee or tail fee unless an offering or other type of transaction (as set forth in the agreement) is consummated within two years of the date the engagement is terminated by the issuer;

(6) through (11) No Change.

(h) through (i) No Change.

(j) Definitions

The definitions in Rule 5121 are incorporated herein by reference. For purposes of this Rule, the following terms have the meanings stated below:

(1) through (7) No Change.

(8) Immediate Family

The term "immediate family" means:

(A) the spouse or children of an associated person of a member; and

(B) No Change.

(9) through (10) No Change.

(11) Insurance Company

For the purposes of paragraph (d) of this Rule, the term "insurance company" refers only to the regulated entity, not its subsidiaries or other affiliates.

(12) through (18) No Change.

(19) Required Filing Date

(A) The term "required filing date" means the dates referenced in paragraph (a)(3) of this Rule; and

(B) For a public offering exempt from filing under paragraph (h) of this Rule, the term "required filing date" means the date the public offering would have been required to be filed with FINRA but for the exemption.

(20) No Change.

(21) Total Equity Securities

For the purposes of paragraph (d) of this Rule, the term "total equity securities" means the aggregate of the total shares of:

(A) common stock outstanding of the issuer; and

(B) common stock of the issuer underlying all convertible securities outstanding that convert without the payment of any additional consideration.

(22) No Change.

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

.01 Underwriting Compensation

(a) The following are examples of payments or benefits that are considered underwriting compensation:

(1) through (12) No Change.

(13) any compensation paid to any participating member in connection with a prior proposed public offering that was not completed, if the member firm participates in the revised public offering, except that accountable expenses received pursuant to paragraph (g)(5)(A) of this Rule shall not be deemed underwriting compensation; and

(14) No Change.

(b) Participating members may receive payments from an issuer or another source during the review period that may be unrelated to a particular offering. Such payments generally would not be deemed to be underwriting compensation. The following list, while not comprehensive, provides examples of payments that are not deemed to be underwriting compensation:

(1) through (18) No Change.

(19) non-convertible [or]and non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction that is unrelated to the public offering;

(20) No Change.

(21) securities acquired in the secondary market by a participating member that is a broker-dealer in connection with the performance of bona fide customer facilitation activities and bona fide market making activities; provided that securities acquired from the issuer will be considered "underwriting compensation" if the securities were not acquired at a fair price (taking into

account, among other things customary commissions, mark-downs and other charges); [and]

(22) securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court (e.g., bankruptcy or tax court proceeding);[.]

(23) securities acquired by a lender affiliated with a participating member through a debt-for-equity exchange that is sold by its affiliated member, if:

(A) the debt-for-equity exchange was structured to provide economic and tax benefits to the issuer and not the lender or affiliated member, except for the compensation in subparagraph (D) of this Supplementary Material .01(b)(23);

(B) the affiliated member subsequently offered all of the equity securities the lender acquired in a firm commitment offering following the debt exchange;

(C) the terms negotiated in connection with the debt exchange and the subsequent equity offering were determined through arms' length negotiations based on the market price of the equity exchanged, subject to the compensation in subparagraph (D) of this Supplementary Material .01(b)(23); and

(D) the affiliated member negotiated customary compensation for the subsequent equity offering; and

(24) securities acquired before or during the distribution of an offering by a participating member in the issuer or an affiliated entity in connection with the

investment of cash to capitalize a direct participation program or a real estate investment trust, as defined in Rule 2231(d), provided that:

(A) the acquisition of securities is disclosed in the issuer's prospectus as a capital investment or a comparable form of capitalization;

(B) the securities offered to the public and the securities acquired in the capitalization transaction are valued and priced on a net asset value or NAV basis;

(C) the offering for which the participating member is engaged is an offering subject the requirements of Rule 2310; and

(D) the securities acquired and excluded are not sold, transferred, assigned, pledged or hypothecated, or be the subject of any hedging, short sale, derivative, put or call transaction that would result in the effective economic disposition of the securities for a period of 180 days beginning on the date of commencement of sales of the public equity offering.

(c) No Change.

.02 Venture Capital Transactions and Significantly Delayed Offerings.

Notwithstanding paragraph (d) of this Rule, in the event that an offering is significantly delayed and the issuer needs funding pending consummation of the public offering, FINRA may exclude from underwriting compensation any securities acquired in a transaction that otherwise meets the requirements in paragraph (d), but occurs after the required filing date. To determine whether an acquisition of securities that occurs after the required filing date may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.03 Underwriting Compensation Securities Acquired Other than from the Issuer. Notwithstanding paragraph (j)(22) of this Rule, FINRA may exclude securities acquired from a third-party entity from underwriting compensation. To determine whether an acquisition of securities from a third-party entity may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.04 Underwriting Compensation Resulting from Issuer Directed Sales Programs. Notwithstanding paragraph (j)(15) and (22) of this Rule, FINRA may exclude from underwriting compensation securities acquired by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program. To determine whether an acquisition of securities by a participating member's associated persons or their immediate family pursuant to an issuer directed sales program may be excluded from underwriting compensation, FINRA will consider the following factors, as well as any other relevant factors and circumstances:

(a) through (c) No Change.

.05 No Change.

.06 Non-Convertible, [or]Non-Exchangeable Debt or Preferred Securities and Derivative[s] Instruments

(a) Non-convertible, [or]non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering and at a fair price, will be considered underwriting compensation but will have no compensation

value. Non-convertible, [or]non-exchangeable debt or preferred securities and derivative instruments acquired in a transaction related to the public offering but not at a fair price, will be considered underwriting compensation and subject to the normal valuation requirements of this Rule.

(b) The term “derivative instrument” means any "eligible OTC derivative instrument" as defined in SEA Rule 3b-13(a)(1), (2) and (3). The term “fair price” means the participating members have priced a derivative instrument or non-convertible, [or] non-exchangeable debt or preferred security in good faith; on an arm’s length, commercially reasonable basis, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. A derivative instrument or other security received as compensation for providing services for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services will not be deemed to be entered into or acquired at a fair price.

.07 Venture Capital Transactions. The determination of whether a securities acquisition may be excluded from underwriting compensation pursuant to paragraph (d) of this Rule is to be made at the time of the securities acquisition.

* * * * *

5123. Private Placements of Securities

(a) No Change.

(b) Exemptions

The following private placements are exempt from the requirements of this Rule:

(1) offerings sold by the member or person associated with the member solely to any one or more of the following:

(A) through (I) No Change.

(J) accredited investors described in Securities Act Rule 501(a)(1), (2), (3), [or] (7), (9) or (12).

(2) through (14) No Change.

(c) through (d) No Change.

* * * * *