

Notice to Members

FEBRUARY 2004

SUGGESTED ROUTING

Legal & Compliance
Operations
Senior Management

KEY TOPICS

Bridge Loans
Compensation Limitations
Derivatives
Investment Banking
Rule 2710
Rule 2810
Venture Capital

INFORMATIONAL

Amendments to the Corporate Financing Rule

SEC Approves Amendments to Rule 2710 (Corporate Financing Rule) and Rule 2720 (Distribution of Securities of Members and Affiliates—Conflicts of Interest);

Effective Date: March 22, 2004

Executive Summary

On December 23, 2003, the Securities and Exchange Commission (SEC) approved amendments to Rule 2710 (Corporate Financing Rule or Rule) and Rule 2720 (Distribution of Securities of Members and Affiliates—Conflicts of Interest Rule) that modernize and simplify the Rules to better reflect the various financial activities of multi-service firms (Rule Amendments).¹ The Corporate Financing Rule regulates underwriting compensation and prohibits unfair arrangements in connection with public offerings of securities. The Rule requires members to file with NASD information about initial public offerings (IPOs) and certain secondary offerings. The Corporate Financing Department (Department) reviews this information prior to commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of applicable NASD rules.

The SEC Approval Order, which includes the text of the Rules, is available at www.nasdr.com/filings/rf00_04.asp. The Approval Order contains a detailed discussion of the application of the Rule Amendments. Members with questions regarding the application of the Rules should review the information in the Approval Order in addition to the information provided in this *Notice*.

Questions/Further Information

Questions regarding the *Notice* may be directed to Minh Le or Joani Ward, Assistant Supervisors, Corporate Financing Department, NASD, at (240) 386-4623.

A. Background and Discussion

In recent years, many NASD members have expanded the variety of services that they provide to their corporate financing clients. These services may include venture capital investment, financial consulting, commercial lending, hedging risk through derivative transactions, and investment banking. In addition, the pace of corporate financing activity has accelerated, and the typical time between private fundraising and an issuer's IPO has been shortened. As a result of these developments, NASD proposed amendments to the Corporate Financing Rule to ensure that the Rule would accommodate the modern, legitimate corporate financing activities of members, while protecting issuers and investors from unreasonable or coercive practices.

B. Underwriting Compensation

The Corporate Financing Rule, prior to the amendments discussed in this *Notice*, provides that any "item of value" acquired by the underwriter and related persons within the 12-month period before the filing date of a public offering will be examined by the Department to determine whether it was acquired "in connection with the public offering," and, as such, deemed to be underwriting compensation. Moreover, the Rule currently presumes that any item of value acquired within the six-month period before filing is underwriting compensation; this presumption, however, may be rebutted based on information provided to the Department.

As amended, the Corporate Financing Rule contains a more objective standard for members and the Department to use to determine whether "items of value," such as fees and securities received by underwriters and related persons, must be included in the calculation of underwriting compensation under the Rule. In this regard, Rule 2710(c)(3)(A) sets forth a non-exclusive list of specific types of "items of value" that, along with all other items of value received or to be received by underwriters and related persons in connection with or related to the distribution of the public offering, will be included for purposes of determining the amount of underwriting compensation received or to be received. Rule 2710(c)(3)(B), in turn, provides a list of items that will not be considered "items of value" for purposes of the Rule.

"Items of value" received by an underwriter or related person during the 180-day period before filing the registration statement or other information with the Department and up to the time of the offering's effectiveness or commencement of sales (Review Period) are deemed to be underwriting compensation unless the securities were received in a transaction that meets one of five exceptions contained in the Rule. These exceptions are described below.

C. Exceptions From Underwriting Compensation

The Rule Amendments provide five exceptions, which identify types of transactions in which securities acquired in connection with the transactions, though items of value, will not be considered to be underwriting compensation. The exceptions are intended to cover identified *bona fide* capital-raising transactions.

1. Purchases and Loans by Certain Entities

This exception applies to securities received as consideration for certain investments and loans by entities that are affiliates of members. To fall within this exception, these affiliated entities must meet certain capital and other requirements that are designed to ensure that they are engaged in *bona fide* businesses providing loans to, or venture capital investments in, other companies. This exception limits the amount of securities of an issuer that may be acquired in transactions during the Review Period to 25 percent.

2. Investment in and Loans to Certain Issuers

This exception applies to the acquisition of securities of issuers that have significant institutional investor involvement in their corporate governance. The exception is available for acquisitions by qualifying related entities in a private placement or as compensation for a loan or credit facility. To fall within this exception, the entities also must meet certain capital and other requirements to ensure that the entities have been primarily engaged in the business of making investments in or loans to other companies. The exception limits the amount of securities of an issuer that may be acquired in a transaction to 25 percent. Unlike the first exception, however, it applies the 25 percent threshold to each acquisition of securities under the exception.

3. Private Placements with Institutional Investors

This exception applies to venture capital investments or the receipt of securities as compensation for acting as a placement agent in transactions that include significant institutional investor participation. The exception includes the requirement that an institutional investor that is not affiliated with any member participating in the public offering must have negotiated, established or approved the terms of the investment. In addition, underwriters and related persons, in the aggregate, may not purchase or receive as placement agent compensation securities in an amount that exceeds 20 percent of the amount of securities sold in the private placement.

4. Acquisitions and Conversions to Prevent Dilution

This exception applies to acquisitions of securities that are acquired as the result of: (1) a qualifying right of preemption or a stock-split or a pro-rata rights or similar offering, or (2) the conversion of securities that have not been deemed by NASD to be underwriting compensation. The only terms of the purchased securities that could be different from the terms of securities purchased by other investors would be pre-existing contractual rights that were granted in connection with a prior purchase.

Further, the opportunity to purchase or receive additional securities must have been provided to all similarly situated security holders. Finally, the amount of securities purchased or received must not have increased the recipient's percentage ownership of the same generic class of securities of the issuer, except in the case of conversions and passive increases that result from another investor's failure to exercise its own rights. The Rule Amendments include a definition of a "right of preemption" and list the circumstances under which a purchaser might receive a preemptive right.

5. Purchases Based on a Prior Investment History

This exception applies to acquisitions made in private placements during the Review Period in order to prevent dilution of a long-standing equity interest in the issuer. To be eligible for the exception, the investor must have made at least two prior purchases of the issuer's securities: at least one investment must have been made at least 24 calendar months before the required filing date and a second investment must have been made more than 180 days before the required filing date.

D. Securities Excluded as an Item of Value

The Rule Amendments also list securities, fees, and expenses that are excluded from the definition of "item of value." Securities, fees, and expenses that are not items of value are not deemed to be underwriting compensation and, as further discussed below, are not subject to the Rule's lock-up restrictions.

1. Listed Securities

The Rule Amendments provide that listed securities purchased in public market transactions are not treated as items of value. In addition, the Rule Amendments provide a definition of "listed securities" that specifies the eligible markets and exchanges on which such securities must be listed to meet the definition.

2. Debt Securities and Derivative Instruments

The Rule Amendments provide that nonconvertible or non-exchangeable debt securities and derivative instruments are not items of value if acquired or entered into: (1) for a fair price; (2) in the ordinary course of business; and (3) in transactions unrelated to the public offering. In addition, any securities received in settlement of a derivative that is entered into at a fair price also do not have a compensation value.

a. Fair Price Definition

The Rule Amendments define "fair price" debt securities and derivative instruments to be those that the underwriters and related persons have priced in good faith, on an arms' length basis, in a commercially reasonable manner, and in accordance with pricing methods and models and procedures used in the ordinary course of their business for pricing similar transactions. This "fair price" definition is intended to distinguish covered debt and derivative transactions from a transaction in which the benefit to the underwriter or related person is related to the underwriting or similar

services provided to the issuer. The fair price definition excludes a derivative instrument or other security received for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition, or any other service, including underwriting services. The Rule Amendments provide that any debt or derivative transaction acquired or entered into at a fair price and any item of value received or receivable in the exercise or settlement of such debt or derivative transaction shall have no underwriting compensation value.

b. Filing Requirement

To be excluded from the definition of “item of value,” the Rule Amendments require that the debt securities and derivative instruments be acquired or entered into “in transactions unrelated to the public offering.” Generally, a transaction occurring within the Review Period that is negotiated by personnel in a member’s investment banking department would not be considered to be “unrelated to the public offering.”²

The Rule Amendments provide that information regarding debt and derivative transactions that are *related to the public offering* must be filed if the related public offering is subject to the filing requirements of the Rule (e.g., a derivative transaction designed to hedge the interest rate risk in a non-investment grade rated debt offering). The information initially filed may be limited to a brief description of the transaction and a representation that the transaction was (or if the pricing terms have not been set will be) entered into at a fair price as defined in the Rule. The required information must be submitted only with respect to the particular public offering to which a particular debt security or derivative instrument relates. The Department will evaluate the information submitted on a case-by-case manner. In this regard, the Department will determine that a debt security or derivative instrument acquired in a transaction at a fair price has a compensation value only if facts and circumstances indicate that the transaction is structured so that the risk to the underwriter or related person and the benefit to the customer is minimal, in comparison to the benefit received by the underwriter or related person.³

c. Fair Price Derivatives or Debt Securities Acquired in Transactions Related to an Offering that is Exempt from the Filing Requirements

The Corporate Financing Rule also specifies that offerings exempt from the Rule’s filing requirements, such as offerings of investment-grade rated debt or shelf offerings by issuers with a 36-month reporting history and \$150 million public float, nevertheless must comply with other provisions of the Rule. Accordingly, members must ensure that the underwriting terms and arrangements comply with the Rule. If a participating member has entered into a fair price derivative transaction in connection with an offering that is exempt from the Rule’s filing requirements, members or their counsel must evaluate the facts and circumstances and reasonably determine that the transaction was executed at a fair price and, therefore, has no compensation value. In making such determination, members or their counsel would apply the same test as that applied by the Department (and discussed in subsection b above)—*i.e.*, whether

the transaction was, in fact, not entered into at a fair price because the risk to the underwriter or related person and the benefit to the customer is minimal, in comparison to the benefit received by the underwriter or related person.

3. Pooled Investment Vehicles

The Rule Amendments provide that securities acquired through stock bonus, pension, or profit-sharing plans that qualify under Section 410 of the Internal Revenue Code and shares of an investment company registered under the Investment Company Act of 1940, will not be considered items of value.

4. Cash Compensation

The Rule Amendments clarify that cash compensation for acting as placement agent for a private placement or for providing a loan, credit facility, or for services in connection with merger and acquisitions, will not be considered items of value.

E. Lock-up Restriction

The Rule Amendments narrow the application of the lock-up restriction to public equity offerings. The Rule Amendments provide that common or preferred stock, options, warrants, and other equity securities of the issuer that are unregistered and acquired by an underwriter or related person within 180 days before the filing of the registration statement, or acquired after the filing of the registration statement and deemed to be compensation by NASD, are subject to a 180-day lock-up. All securities that are acquired in transactions that meet the requirements of the five exceptions discussed above also are subject to the lock-up. The Rule Amendments prohibit any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities subject to the lock-up, in order to prevent circumvention of the lock-up restrictions.

The Rule Amendments contain several exceptions to the lock-up restriction. If the aggregate amount of securities of the issuer held by the underwriter or related persons does not exceed 1 percent of the securities being offered, the securities are not subject to the lock-up. In addition, the Rule Amendments provide exceptions for certain investment funds, transfers of securities that are not considered to be an item of value, transfers by operation of law or reorganization of the issuer, and transfers of securities that were previously, but no longer are, subject to a lock-up restriction in connection with a prior public offering. The Rule Amendments also: (1) provide an exception for transfers of securities to any member participating in the offering and officers or partners thereof if all the securities so transferred remain subject to the lock-up restriction and (2) allow the exercise or conversion of any security if all the securities received remain subject to the lock-up restriction for the remainder of the time period.

The Rule Amendments also provide an exception to the lock-up for fair price derivatives acquired in connection with a public offering that are not deemed to be underwriting compensation.⁴ Nevertheless, when an underwriter or related person acquires unregistered equity securities of an issuer as the result of the settlement of such a fair price derivative contract, the unregistered equity securities are subject to the lock-up provision of the Rule to the same extent as any other unregistered equity securities. Some members urged NASD to exempt such acquisitions from the lock-up, noting, for example, that issuer puts in connection with repurchase programs and certain shareholder hedging transactions could be adversely affected when settled in unregistered equity securities during the 180-day period. NASD is concerned, however, that underwriters holding significant amounts of unregistered equity could dilute or manipulate the market for an issuer's securities immediately following a public offering, especially in the case of thinly traded issuers. Accordingly, the Department will consider, on a case-by-case basis, whether to exempt from the Rule those unregistered equity securities necessary as the result of settlement of fair price derivatives. In conducting such reviews, the Department will consider whether the lock-up restriction is interfering with *bona fide* hedging activity that benefits an issuer and its shareholders.

The Rule Amendments also provide an exception from the lock-up restrictions for Rule 144A securities acquired after the completion of the issuer's IPO.

F. NASD Affiliation

The Rule Amendments eliminate the requirement to file information on the NASD affiliation or association of every shareholder of the issuer. Instead, the Rule Amendments require members to file information on the NASD affiliation of any: (1) officer or director of the issuer; (2) beneficial owner of 5 percent or more of any class of the issuer's securities; and (3) beneficial owner of the issuer's unregistered equity securities purchased during the 180-day period immediately preceding the filing date of the public offering (except purchases through an issuer's employee stock purchase plan).

G. Required Filing Date

The Rule Amendments provide that the required filing date is no later than one business day after the registration statement or other offering documents are filed or submitted to the SEC, state securities commission or other regulatory authority, or if not filed, 15 days prior to the anticipated date on which offers will commence. Offerings submitted to the SEC for review on a confidential basis will be considered filed with the SEC as of the date of the confidential submission.

H. Review Period for Pre-Offering Compensation

The Rule Amendments provide that the receipt of securities for purposes of the Review Period will be deemed to be: (1) the date of the closing of a private placement; (2) the date a loan or credit agreement is executed; or (3) the date beneficial ownership is transferred as consideration for financial advisory or consulting services, merger or acquisition services, acting as a finder, or for any other service.

I. Undisclosed Items of Value or Those Received After Completion of an Offering

The Rule Amendments require members to file information with the Department regarding the receipt of items of value by participating members during the 90-day period following the effective date of a registration statement. In addition, all items of value received and all arrangements entered into for the future receipt of an item of value that are not disclosed to NASD prior to the issuance of a "no objections" letter must be disclosed in order for the Department to determine whether such items of value are in fact underwriting compensation for the public offering.

J. Valuation of Securities

The Rule, prior to the amendments discussed in this *Notice*, prohibits underwriters or related persons from receiving warrants as compensation that have an exercise price below the public offering price. The Rule Amendments eliminate this prohibition, but require such warrants to be valued in accordance with the valuation provisions in the Rule, to be included in the compensation calculations, and to be subject to the compensation limitations.

The Rule Amendments clarify that an underwriter or related person may not receive as compensation a security, a warrant, or a convertible security unless the security received or the security underlying the warrant or convertible security is identical to the security offered to the public or to a security with a *bona fide* independent market, or the security can be accurately valued in accordance with the valuation provisions in the Rule.

The Rule Amendments also clarify that the application of the valuation method depends on whether the security has an exercise or conversion price. Convertible securities with no conversion price are valued in the same manner as common stock.

The valuation methods in the Rule provide a minimum compensation value to securities with a high exercise price. Otherwise, securities with, for example, an exercise price of 165 percent of the public offering price would have a zero valuation. The Rule Amendments provide that securities with an exercise price must have a minimum compensation value of .2 percent of the offering proceeds for each amount of securities that is up to 1 percent of the securities being offered, excluding securities subject to an overallotment option.

The Rule Amendments provide lower valuations of securities with longer lock-up restrictions. A lower value of 10 percent of the value of securities acquired as underwriting compensation will be deducted for each 180-day lock-up period beyond the mandatory 180-day lock-up period.⁵ Transfers permitted by certain exceptions to the lock-up provisions are not permitted for securities whose valuation has been reduced by undertaking to abide by the longer lock-up periods.

K. Exemptive Authority

In reviewing the proposed Rule Amendments, commenters noted that financial services transactions are complex and sometimes have unusual or unique structures not contemplated by the Rule Amendments as drafted. These commenters urged NASD to retain flexibility in its application of the rule provisions.

In response to these comments, Rule 2710(j) provides NASD staff with the authority to provide exemptions from the Rule. Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of the Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest. In its Approval Order, the SEC concluded that this exemptive authority is reasonable and provides NASD staff the authority to exempt transactions that, although covered by the Rule, the Rule was not intended to address.⁶

Endnotes

- 1 See Release No. 34-48989 (SR-NASD-2000-04) (December 23, 2003), 68 FR 75684 (December 31, 2003) (Approval Order).
- 2 An exception to this general principle would be a put option or other derivative instrument that is entered into by an issuer with an underwriter or related person in connection with a publicly disclosed share repurchase program. The public disclosure and transparent nature of the repurchase program distinguish the derivative transaction in support of the program from other privately negotiated transactions between the investment bankers and the issuer during the Review Period.
- 3 NASD staff recognizes that the fact that a debt security or derivative instrument turns out to be more or less favorable to a party as the result of unanticipated market movements or other events subsequent to entry into a transaction would not necessarily mean that the transaction was done at an unfair price or that it could necessarily be characterized as underwriting compensation.
- 4 Fair price derivatives acquired in transactions unrelated to a public offering are not “items of value,” and accordingly not subject to the lock-up restrictions.
- 5 For example, the underwriting compensation value of securities with a value of 2.50 percent will be reduced to 2.25 percent if the securities are restricted for one year from the effective date and to 2 percent if the securities are restricted for 18 months following the effective date.
- 6 See Approval Order, 68 FR at 75701. The Department generally would not use its exemptive authority to exclude transactions that narrowly fail to meet one or more criteria of the Rule.

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ATTACHMENT A

New text is underlined; deletions are in brackets.

2710. Corporate Financing Rule - Underwriting Terms and Arrangements

(a) Definitions

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

The definitions in Rule 2720 are incorporated herein by reference.

(1) Issuer

The issuer of the securities offered to the public, any selling security holders offering securities to the public, any affiliate of the issuer or selling security holder, and the officers or general partners, directors, employees and security holders thereof[;].

(2) Net Offering Proceeds

Offering proceeds less all expenses of issuance and distribution[;].

(3) Offering Proceeds

Public offering price of all securities offered to the public, not including securities subject to any overallotment option, securities to be received by the underwriter and related persons, or securities underlying other securities[;].

(4) Participating Member(s)

Any NASD member that is participating in a public offering, any associated person of the member, any members of their immediate family, and any affiliate of the member.

[(4)] (5) Participation or Participating in a Public Offering

Participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, furnishing of customer and/or broker lists for solicitation, or participation in any advisory or consulting capacity to the issuer related to the offering, but not the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEC Rule 13e-3[; and].

[(5)] (6) Underwriter and Related Persons

[Includes underwriters,] Consists of underwriter's counsel, financial consultants

and advisors, finders, [members of the selling or distribution group,] any participating member [participating in the public offering], and any [and all] other persons [associated with or] related to any participating member [and members of the immediate family of any of the aforementioned persons].

(7) Listed Securities

Securities meeting the listing standards to trade on the national securities exchanges identified in SEC Rule 146, markets registered with the SEC under Section 6 of the Exchange Act, and any offshore market that is a “designated offshore securities market” under Rule 902(b) of SEC Regulation S.

(8) Derivative Instruments

A derivative instrument is any “eligible OTC derivative instrument” as defined in SEC Rule 3b-13(a)(1), (2) and (3).

(9) Fair Price

A derivative instrument or non-convertible or non-exchangeable debt security has been acquired or entered into at a fair price for purposes of subparagraphs (b)(6)(A)(iv), (c)(3)(B)(vi) and (vii), and (e)(5) if the underwriters and related persons have priced the debt security or derivative instrument 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 for acting as a private placement agent for the issuer, for providing or arranging a loan, credit facility, merger, acquisition or any other service, including underwriting services, is not included within this “fair price” definition.

(10) Required Filing Date

The required filing date shall be the dates provided in subparagraph (b)(4), and for a public offering exempt from filing under subparagraph (b)(7), the required filing date for purposes of subparagraph (d) and (g) shall be the date the public offering would have been required to be filed with the NASD but for the exemption.

(b) Filing Requirements

(1) - (3) No change.

(4) Requirement for Filing

(A) Unless filed by the issuer, the managing underwriter, or another member, a member that anticipates participating in a public offering of securities subject to this Rule shall file with [the Association] NASD the documents and information with respect to the offering specified in subparagraphs (5) and (6) below:

(i) no later than one business day after [the filing of] any such documents are filed with or submitted to:

[(i)] a. [with]the Commission; or

[(ii)] b. [with the] any state securities commission or
other regulatory authority; or

[(iii)] with any other regulatory authority; or

[(iv)] (ii) if not filed with or submitted to any regulatory authority, at least fifteen [(15)] business days prior to the anticipated [offering] date on which offers will commence.

(B) No [offering] sales of securities subject to this Rule shall commence unless:

(i) the documents and information specified in subparagraphs (5) and (6) below have been filed with and reviewed by [the Association] NASD; and

(ii) No change.

(C) No change.

(5) No change.

(6) Information Required to be Filed

(A) Any person filing documents with the NASD that are required to be filed under paragraph (b)(4) above shall provide the following information with respect to the offering through [the Association's] NASD's electronic filing system:

(i) - (ii) No change.

(iii) a statement of the association or affiliation with any

member of any officer[,] or director of the issuer, of any [or security holder] beneficial owner of [the issuer in an initial public offering of equity securities, and with respect to any other offering provide such information with respect to any officer, director or security holder of five percent] 5% or more of any class of the issuer's securities, and of any beneficial owner of the issuer's unregistered equity securities that were acquired during the 180-day period immediately preceding the required filing date of the public offering, except for purchases described in subparagraph (c)(3)(B)(iv) below. This statement must identify [to include]:

a. [the identity of] the person;

b. [the identity of] the member and whether such member is participating in any capacity in the public offering; and

c. the number of equity securities or the face value of debt securities owned by such person, the date such securities were acquired, and the price paid for such securities.

(iv) [a statement addressing the factors in subparagraphs (c)(4)(C) and (D), where applicable;]

[(v)] a detailed explanation of any other arrangement entered into during the [12-month] 180-day period immediately preceding the required filing date of the public offering, which arrangement provides for the receipt of any item of value [and/]or the transfer of any warrants, options, or other securities from the issuer to the underwriter and related persons, provided however: [;and]

a. information regarding debt securities and derivative instruments not considered an item of value under subsection (c)(3)(B)(vi) and (vii) is not required to be filed; and

b. information initially filed in connection with debt securities and derivative instruments acquired or entered into

for a "fair price" as defined in subsection (a)(9), but not excluded from items of value under subsection (c)(3)(B)(vi) or (vii), may be limited to a brief description of the transaction (additional information may be required in the review process) and a representation by the member that a registered principal or senior manager on behalf of the member has determined that the transaction was or (if the pricing terms have not been set) will be entered into at a fair price as defined in subsection (a)(9).

(v) a statement demonstrating compliance with all of the criteria of an exception from underwriting compensation in subparagraph (d)(5) below, when applicable; and

(vi) a detailed explanation and any documents related to:

a. the modification of any information or representation previously provided to the NASD or of any item of underwriting compensation, including the information required in subparagraph (b)(6)(A)(iii) above with respect to any securities of the issuer acquired subsequent to the required filing date and prior to the effectiveness or commencement of the offering[,] ; or

b. any new arrangement that provides for the receipt of any additional item of value by any participating member subsequent to the [review and approval of such compensation] issuance of an opinion of no objections to the underwriting terms and arrangements by [the Association] NASD and within 90 days immediately following the date of effectiveness or commencement of sales of the public offering, provided, however, that information filed in connection with debt securities and derivative instruments acquired or entered into for a "fair price" as defined in

subsection (a)(9) may be limited as described in subsection (b)(6)(A)(iv)b.

(vii) any other information required to be filed under this Rule.

(B) No change.

(7) - (11) No change.

(c) Underwriting Compensation and Arrangements

(1) General

No member or person associated with a member shall participate in any manner in any public offering of securities in which the underwriting or other terms or arrangements in connection with or relating to the distribution of the securities, or the terms and conditions related thereto, are unfair or unreasonable.

(2) Amount of Underwriting Compensation

(A) No member or person associated with a member shall receive an amount of underwriting compensation in connection with a public offering [which] that is unfair or unreasonable and no member or person associated with a member shall underwrite or participate in a public offering of securities if the underwriting compensation in connection with the public offering is unfair or unreasonable.

(B) – (D) No change.

(E) The maximum amount of compensation (stated as a percentage of the dollar amount of the offering proceeds) [which] that is considered fair and reasonable generally will vary directly with the amount of risk to be assumed by [the underwriter and related persons] participating members and inversely with the dollar amount of the offering proceeds.

(3) Items of [Compensation] Value

(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to subparagraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the public offering,

as determined pursuant to [sub]paragraph [(4)] (d) below shall be included:

(i) - (iii) No change.

(iv) finder's fees, whether in the form of cash, securities or any other item of value;

(v) wholesaler's fees;

(vi) financial consulting and advisory fees, whether in the form of cash, securities, or any other item of value;

(vii) common or preferred stock, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities, [including securities] received [as underwriting compensation, for example]:

a. [in connection with a] for acting as private placement agent [of securities] for the issuer;

b. for providing or arranging a loan, credit facility [bridge financing] merger or acquisition services, or any other service for the issuer;

[c. as a finder's fee;]

[d. for consulting services to the issuer; and]

[e.] c. [securities purchased] as an investment in a private placement made by the issuer; or

d. at the time of the public offering.

(viii) special sales incentive items [in compliance with subparagraph (6)(B)(xi)];

(ix) any right of first refusal provided to [the underwriter and related persons] any participating member to underwrite or participate in future public offerings, private placements or other financings, which will have a compensation value of 1% of the offering proceeds or that dollar amount contractually agreed to by the issuer and underwriter to waive or terminate the right of first refusal;

(x) No change.

(xi) commissions, expense reimbursements, or other compensation to be received by the underwriter and related persons as a result of the exercise or conversion, within twelve [(12)] months following the effective date of the offering, of warrants, options, convertible securities, or similar securities distributed as part of the public offering;

(xii) fees of a qualified independent underwriter; and

(xiii) compensation, including expense reimbursements, previously paid [in the six (6) months prior to the initial or amended filing of the prospectus or similar documents] to any member in connection with a [or person associated with a member for a] proposed public offering that was not completed[.], unless the member does not participate in the revised public offering.

(B) Notwithstanding subparagraph (c)(3)(A) above, the following shall not be considered an item of value:

(i) [E] expenses customarily borne by an issuer, such as printing costs; SEC, "blue sky" and other registration fees; [the Association] NASD filing fees; and accountant's fees, [shall be excluded from underwriter's compensation] whether or not paid through [an underwriter] a participating member;

(ii) cash compensation for acting as placement agent for a private placement or for providing a loan, credit facility, or for services in connection with a merger/acquisition;

(iii) listed securities purchased in public market transactions;

(iv) securities acquired through any stock bonus, pension, or profit-sharing plan that qualifies under Section 401 of the Internal Revenue Code;

(v) securities acquired by an investment company registered under the Investment Company Act of 1940;

(vi) non-convertible or non-exchangeable debt securities

acquired for a fair price in the ordinary course of business in transactions unrelated to the public offering; and

(vii) derivative instruments entered into for a fair price in the ordinary course of business in a transaction unrelated to the public offering.

[(4)] (d) Determination of Whether [Compensation Is Received in Connection with the Offering] Items of Value Are Included In Underwriting Compensation

[(A)] (1) Pre-Offering Compensation

All items of value received [or to be received] and all arrangements entered into for the future receipt of an item of value by the underwriter and related persons during the [twelve (12) month] period commencing 180 days immediately preceding the required filing date of the registration statement or similar document pursuant to subparagraph (b)(4) above[, and at the time of and subsequent to] until the date of effectiveness or commencement of sales of the public offering[,], will be [examined to determine whether such items of value are] considered to be underwriting compensation in connection with the public offering [and, if received during the six (6) month period immediately preceding the filing of the registration statement or similar document, will be presumed to be underwriting compensation received in connection with the offering, provided, however, that such presumption may be rebutted on the basis of information satisfactory to the Association to support a finding that the receipt of an item is not in connection with the offering and shall not include cash discounts or commissions received in connection with a prior distribution of the issuer's securities].

(2) Undisclosed and Post-Offering Compensation

All items of value received and all arrangements entered into for the future receipt of an item of value by any participating member that are not disclosed to the NASD prior to the date of effectiveness or commencement of sales of a public offering, including items of value received subsequent to the public offering, are subject to post-offering review to determine whether such items of value are, in fact, underwriting compensation for the public offering.

[(B)] Items of value received by an underwriter and related person more

than twelve (12) months immediately preceding the date of filing of the registration statement or similar document will be presumed not to be underwriting compensation. However, items received prior to such twelve (12) month period may be included as underwriting compensation on the basis of information to support a finding that receipt of the item is in connection with the offering.]

[(C) For purposes of determining whether any item of value received or to be received by the underwriter and related persons is in connection with or related to the distribution of the public offering, the following factors, as well as any other relevant factors and circumstances, shall be considered:]

[(i) the length of time between the date of filing of the registration statement or similar document and:]

[a. the date of the receipt of the item of value;]

[b. the date of any contractual agreement for services for which the item of value was or is to be received; and]

[c. the date the performance of the service commenced, with a shorter period of time tending to indicate that the item is received in connection with the offering;]

[(ii) the details of the services provided or to be provided for which the item of value was or is to be received;]

[(iii) the relationship between the services provided or to be provided for which the item of value was or is to be received and:]

[a. the nature of the item of value;]

[b. the compensation value of the item; and]

[c. the proposed public offering;]

[(iv) the presence or absence of arm's length bargaining or the existence of any affiliate relationship between the issuer and the recipient of the item of value, with the absence of arm's length bargaining or the presence of any affiliation tending to indicate that the item of value is received in connection with the offering.]

[(D) For purposes of determining whether securities received or to be received by the underwriter and related persons are in connection with or related to the distribution of the public offering, the factors in subparagraph (C) above and the following factors shall be considered:]

[(i) any disparity between the price paid and the offering price or the market price, if a bona fide independent market exists at the time of acquisition, with a greater disparity tending to indicate that the securities constitute compensation;]

[(ii) the amount of risk assumed by the recipient of the securities, as determined by:]

[a. the restrictions on exercise and resale;]

[b. the nature of the securities (e.g., warrant, stock, or debt); and]

[c. the amount of securities, with a larger amount of readily marketable securities without restrictions on resale or a warrant for securities tending to indicate that the securities constitute compensation; and]

[(iii) the relationship of the receipt of the securities to purchases by unrelated purchasers on similar terms at approximately the same time, with an absence of similar purchases tending to indicate that the securities constitute compensation.]

[(E) Notwithstanding the provisions of subparagraph (3)(A)(vi) above, financial consulting and advisory fees may be excluded from underwriting compensation upon a finding by the Association, on the basis of information satisfactory to it, that an ongoing relationship between the issuer and the underwriter and related person has been established at least twelve (12) months prior to the filing of the registration statement or similar document or that the relationship, if established subsequent to that time, was not entered into in connection with the offering, and that actual services have been or will be rendered which were not or will not be in connection with or related to the

offering.]

(3) Date of Receipt of Securities

Securities of the issuer acquired by the underwriter and related persons will be considered to be received for purposes of subparagraphs (d)(1) and (d)(5) as of the date of the:

(A) closing of a private placement, if the securities were purchased in or received for arranging a private placement; or

(B) execution of a written contract with detailed provisions for the receipt of securities as compensation for a loan, credit facility, or put option; or

(C) transfer of beneficial ownership of the securities, if the securities were received as compensation for consulting or advisory services, merger or acquisition services, acting as a finder, or for any other service.

(4) Definitions

For purposes of subparagraph (d)(5) below, the following terms will have the meanings stated below.

(A) An entity:

(i) includes a group of legal persons that either:

a. are contractually obligated to make co-investments and have previously made at least one such investment; or

b. have filed a Schedule 13D or 13G with the SEC that identifies the legal persons as members of a group that have agreed to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer in connection with a previous investment; and

(ii) may make its investment or loan through a wholly owned subsidiary (except when the entity is a group of legal persons).

(B) An institutional investor is any individual or legal person that has at least \$50 million invested in securities in the aggregate in its portfolio or under management, including investments held by its wholly owned subsidiaries; provided that no participating members direct or otherwise manage the

institutional investor's investments or have an equity interest in the institutional investor, either individually or in the aggregate, that exceeds 5% for a publicly owned entity or 1% for a nonpublic entity.

(C) A bank or insurance company is only the regulated entity, not its subsidiaries or other affiliates.

(D) A right of preemption means the right of a shareholder to acquire additional securities in the same company in order to avoid dilution when additional securities are issued, pursuant to:

(i) any option, shareholder agreement, or other contractual right entered into at the time of a purchase of securities;

(ii) the terms of the security purchased;

(iii) the issuer's charter or by-laws; or

(iv) the domestic law of a foreign jurisdiction that regulates the issuance of the securities.

(E) "Total equity securities" means the aggregate of the total shares of:

(i) common stock outstanding of the issuer; and

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

(5) Exceptions From Underwriting Compensation

Notwithstanding subparagraph (d)(1) above, the following items of value are excluded from underwriting compensation (but are subject to the lock-up restriction in subparagraph (g)(1) below), provided that the member does not condition its participation in the public offering on an acquisition of securities under an exception and any securities purchased are purchased at the same price and with the same terms as the securities purchased by all other investors.

(A) Purchases and Loans by Certain Entities - Securities of the issuer purchased in a private placement or received as compensation for a loan or credit facility before the required filing date of the public offering pursuant to subparagraph (b)(4) above by certain entities if:

(i) each entity:

a. either:

1. manages capital contributions or commitments of \$100 million or more, at least \$75 million of which has been contributed or committed by persons that are not participating members;

2. manages capital contributions or commitments of \$25 million or more, at least 75% of which has been contributed or committed by persons that are not participating members;

3. is an insurance company as defined in Section 2(a)(13) of the Securities Act or is a foreign insurance company that has been granted an exemption under this Rule; or

4. is a bank as defined in Section 3(a)(6) of the Act or is a foreign bank that has been granted an exemption under this Rule; and

b. is a separate and distinct legal person from any member and is not registered as a broker/dealer;

c. makes investments or loans subject to the evaluation of individuals who have a contractual or fiduciary duty to select investments and loans based on the risks and rewards to the entity and not based on opportunities for the member to earn investment banking revenues;

d. does not participate directly in investment banking fees received by any participating member for underwriting public offerings; and

e. has been primarily engaged in the business of making investments in or loans to other companies; and

(ii) all entities related to each member in acquisitions that

qualify for this exception do not acquire more than 25% of the issuer's total equity securities during the review period in subparagraph (d)(1), calculated immediately following the transaction.

(B) Investments In and Loans to Certain Issuers - Securities of the issuer purchased in a private placement or received as compensation for a loan or credit facility before the required filing date of the public offering pursuant to subparagraph (b)(4) above by certain entities if:

(i) each entity:

a. manages capital contributions or commitments of at least \$50 million;

b. is a separate and distinct legal person from any member and is not registered as a broker/dealer;

c. does not participate directly in investment banking fees received by the member for underwriting public offerings;
and

d. has been primarily engaged in the business of making investments in or loans to other companies; and

(ii) institutional investors beneficially own at least 33% of the issuer's total equity securities, calculated immediately prior to the transaction;

(iii) the transaction was approved by a majority of the issuer's board of directors and a majority of any institutional investors, or the designees of institutional investors, that are board members; and

(iv) all entities related to each member in acquisitions that qualify for this exception do not acquire more than 25% of the issuer's total equity securities, calculated immediately following the transaction.

(C) Private Placements With Institutional Investors - Securities of the issuer purchased in, or received as placement agent compensation for, a private placement before the required filing date of the public offering pursuant to

subparagraph (b)(4) above if:

(i) institutional investors purchase at least 51% of the "total offering" (comprised of the total number of securities sold in the private placement and received or to be received as placement agent compensation by any member);

(ii) an institutional investor was the lead negotiator or, if the terms were not negotiated, was the lead investor with the issuer to establish or approve the terms of the private placement; and

(iii) underwriters and related persons did not, in the aggregate, purchase or receive as placement agent compensation more than 20% of the "total offering" (excluding purchases by any entity qualified under subparagraph (d)(5)(A) above).

(D) Acquisitions and Conversions to Prevent Dilution - Securities of the issuer if:

(i) the securities were acquired as the result of:

a. a right of preemption that was granted in connection with securities that were purchased either:

1. in a private placement and the securities are not deemed by the NASD to be underwriting compensation; or

2. from a public offering or the public market; or

b. a stock-split or a pro-rata rights or similar offering;

or

c. the conversion of securities that have not been deemed by the NASD to be underwriting compensation; and

(ii) the only terms of the purchased securities that are different from the terms of securities purchased by other investors are pre-existing contractual rights that were granted in connection with a prior purchase;

(iii) the opportunity to purchase in a rights offering or pursuant to a right of preemption, or to receive additional securities as the result of a stock-split or conversion was provided to all similarly situated securityholders; and

(iv) the amount of securities purchased or received did not increase the recipient's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment, except in the case of conversions and passive increases that result from another investor's failure to exercise its own rights.

(E) Purchases Based On A Prior Investment History - Purchases of securities of the issuer if:

(i) the amount of securities purchased did not increase the purchaser's percentage ownership of the same generic class of securities of the issuer or of the class of securities underlying a convertible security calculated immediately prior to the investment; and

(ii) an initial purchase of securities of the issuer was made at least two years and a second purchase was made more than 180 days before the required filing date of the public offering pursuant to subparagraph (b)(4) above.

[(5)] (e) Valuation of Non-Cash Compensation

For purposes of determining the value to be assigned to securities received as underwriting compensation, the following criteria and procedures shall be applied[.].

[(A) No underwriter and related person may receive a security or a warrant for a security as compensation in connection with the distribution of a public offering that is different than the security to be offered to the public unless the security received as compensation has a bona fide independent market, provided, however, that: (i) in exceptional and unusual circumstances, upon good cause shown, such arrangement may be permitted by the

Association; and (ii) in an offering of units, the underwriter and related persons may only receive a warrant for the unit offered to the public where the unit is the same as the public unit and the terms are no more favorable than the terms of the public unit.]

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

An underwriter and related person 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 independent market; or

(B) the security can be accurately valued, as required by subparagraph (f)(2)(l) below.

[(B)] (2) Valuation of Securities That Do Not Have an Exercise or Conversion Price [s] Securities that [are not options, warrants or convertible securities] do not have an exercise or conversion price shall have a compensation value [be valued on the basis of] based on:

[(i)] (A) the difference between [the per security cost and]:

(i) either the market price per security on the date of acquisition, [where a] or, if no bona fide independent market exists for the security, [or] the [proposed (and actual)] public offering price per security; and

(ii) the per security cost;

[(ii)] (B) multiplied by the number of securities received or to be received as underwriting compensation;

[(iii)] (C) divided by the offering proceeds; and

[(iv)] (D) multiplied by one hundred [(100)].

(3) Valuation of Securities That Have an Exercise or Conversion Price

[(C) o] Options, warrants or convertible securities that have an exercise or

conversion price ("warrants") shall [be valued on the basis of] have a compensation value based on the following formula:

[(i) (A) the [proposed (and actual)] public offering price per security multiplied by .65 [(65%)];

[(ii) (B) minus the [difference between] resultant of the exercise or conversion price per [security] warrant [and] less either:

[(i) the market price per security on the date of acquisition, where a bona fide independent market exists for the security, or

[(ii) the [proposed (and actual)] public offering price per security;

[(iii) (C) divided by two [(2)];

[(iv) (D) multiplied by the number of securities underlying the warrants[, options, and convertible securities received or to be received as underwriting compensation];

[(v) (E) less the total price paid for the [securities] warrants;

[(vi) (F) divided by the offering proceeds; and

[(vii) (G) multiplied by one hundred [(100).];

[(H) provided, however, that, notwithstanding subparagraph (e)(4) below, such warrants shall have a compensation value of at least .2% of the offering proceeds for each amount of securities that is up to 1% of the securities being offered to the public (excluding securities subject to an overallotment option).

(4) Valuation Discount For Securities With a Longer Resale Restriction

[(D) a lower value equal to 80% and 60% of the calculated value shall be assigned if securities, and where relevant, underlying securities, are or will be restricted from sale, transfer, assignment or other disposition for a period of one and two years, respectively, beyond the one-year period of restriction required by subparagraph (7)(A)(i) below.]

A lower value equal to 10% of the calculated value shall be deducted for each 180-day period that the securities or underlying securities are restricted from sale or

other disposition beyond the 180-day period of the lock-up restriction required by subparagraph (g)(1) below. The transfers permitted during the lock-up restriction by subparagraphs (g)(2)(A)(iii)-(iv) are not available for such securities.

(5) Valuation of Items of Value Acquired in Connection with a Fair Price Derivative or Debt Transaction

Any debt or derivative transaction acquired or entered into at a "fair price" as defined in subsection (a)(9) and item of value received in or receivable in the settlement, exercise or other terms of such debt or derivative transaction shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the debt or derivative security is not a fair price, compensation will be calculated pursuant to this subsection (e) or based on the difference between the fair price and the actual price.

[(6)] (f) Unreasonable Terms and Arrangements

[(A)] (1) General

No member or person associated with a member shall participate in any manner in a public offering of securities after any arrangement proposed in connection with the public offering, or the terms and conditions relating thereto, has been determined to be unfair or unreasonable pursuant to this Rule or inconsistent with any By-Law or any Rule or regulation of [the Association] NASD.

[(B)] (2) Prohibited Arrangements

Without limiting the foregoing, the following terms and arrangements, when proposed in connection with [the distribution of] a public offering of securities, shall be unfair and unreasonable[;].

[(i)] (A) [a] Any accountable expense allowance granted by an issuer to the underwriter and related persons [which] that includes payment for general overhead, salaries, supplies, or similar expenses of the underwriter incurred in the normal conduct of business[;].

[(ii)] (B) [a] Any non-accountable expense allowance in excess of [three (3) percent;] 3% of offering proceeds.

[(iii)] (C) [a] Any payment of commissions or reimbursement of expenses

directly or indirectly to the underwriter and related persons prior to commencement of the public sale of the securities being offered, except a reasonable advance against out-of-pocket accountable expenses actually anticipated to be incurred by the underwriter and related persons, which advance is reimbursed to the issuer to the extent not actually incurred[;].

[(iv)] (D) [t]The payment of any compensation by an issuer to a member or person associated with a member in connection with an offering of securities [which] that is not completed according to the terms of agreement between the issuer and underwriter, except those negotiated and paid in connection with a transaction that occurs in lieu of the proposed offering as a result of the efforts of the underwriter and related persons and provided, however, that the reimbursement of out-of-pocket accountable expenses actually incurred by the member or person associated with a member shall not be presumed to be unfair or unreasonable under normal circumstances[;].

[(v)] (E) [a]Any "tail fee" arrangement granted to the underwriter and related persons that has a duration of more than two [(2)] years from the date the member's services are terminated, in the event that the offering is not completed in accordance with the agreement between the issuer and the underwriter and the issuer subsequently consummates a similar transaction, except that a member may demonstrate on the basis of information satisfactory to [the Association] NASD that an arrangement of more than two [(2)] years is not unfair or unreasonable under the circumstances.

[(vi)] (F) [a]Any right of first refusal provided to the underwriter or related persons to underwrite or participate in future public offerings, private placements or other financings [which] that:

[a.] (i) has a duration of more than three [(3)] years from the [effective] date of effectiveness or commencement of sales of the public offering; or

[b.] (ii) has more than one opportunity to waive or terminate the right of first refusal in consideration of any payment or fee[;].

[(vii)] (G) [a] Any payment or fee to waive or terminate a right of first refusal regarding future public offerings, private placements or other financings provided to the underwriter and related persons [which] that:

[a.] (i) has a value in excess of the greater of [one percent (] 1% [)] of the offering proceeds in the public offering where the right of first refusal was granted (or an amount in excess of [one percent] 1% if additional compensation is available under the compensation guideline of the original offering) or [five percent (] 5% [)] of the underwriting discount or commission paid in connection with the future financing (including any overallotment option that may be exercised), regardless of whether the payment or fee is negotiated at the time of or subsequent to the original public offering; or

[b.] (ii) is not paid in cash[;].

[(viii)] (H) The terms or the exercise of the terms of an agreement for the receipt by the underwriter and related persons of underwriting compensation consisting of any option, warrant or convertible security [which] that:

[a.] (i) is exercisable or convertible more than five [(5)] years from the effective date of the offering;

[b.] is exercisable or convertible at a price below either the public offering price of the underlying security or, if a bona fide independent market exists for the security or the underlying security, the market price at the time of receipt;]

[c.] (ii) is not in compliance with subparagraph [(5)(A)] (e)(1) above;

[d.] (iii) has more than one demand registration right at the issuer's expense;

[e.] (iv) has a demand registration right with a duration of more than five [(5)] years from the [effective] date of effectiveness or the commencement of sales of the public offering;

[f.] (v) has a piggyback registration right with a duration of more than seven [(7)] years from the [effective] date of effectiveness or the commencement of sales of the public offering;

[g.] (vi) has anti-dilution terms [designed to provide] that allow the underwriter and related persons [with disproportionate rights, privileges and economic benefits which are not provided to the purchasers of the securities offered to the public (or the public shareholders, if in compliance with subparagraph (5)(A) above)] to receive more shares or to exercise at a lower price than originally agreed upon at the time of the public offering, when the public shareholders have not been proportionally affected by a stock split, stock dividend, or other similar event; or

[h.] (vii) has anti-dilution terms [designed to provide for the receipt or accrual of] that allow the underwriter and related persons to receive or accrue cash dividends prior to the exercise or conversion of the security[; or].

[i. is convertible or exercisable or otherwise is on terms more favorable than the terms of the securities being offered to the public;]

[(ix)] (l) [t]The receipt by the underwriter and related persons of any item of compensation for which a value cannot be determined at the time of the offering[;].

[(x)] (l) [w]When proposed in connection with the distribution of a public offering of securities on a "firm commitment" basis, any over allotment option providing for the over allotment of more than [fifteen (15) percent] 15% of the amount of securities being offered, computed excluding any securities offered pursuant to the over allotment option[;].

[(xi) stock numerical limitation. The receipt by the underwriter and related persons of securities which constitute underwriting compensation in an aggregate amount greater than ten (10) percent of the number or dollar amount of securities being offered to the

public, which is calculated to exclude:]

[a. any securities deemed to constitute underwriting compensation;]

[b. any securities issued pursuant to an overallotment option;]

[c. in the case of a "best efforts" offering, any securities not actually sold; and]

[d. any securities underlying warrants, options, or convertible securities which are part of the proposed offering, except where acquired as part of a unit;]

[(xii)] ~~(K)~~ [t]The receipt by a member or person associated with a member, pursuant to an agreement entered into at any time before or after the effective date of a public offering of warrants, options, convertible securities or units containing such securities, of any compensation or expense reimbursement in connection with the exercise or conversion of any such warrant, option, or convertible security in any of the following circumstances:

[a.](i) the market price of the security into which the warrant, option, or convertible security is exercisable or convertible is lower than the exercise or conversion price;

[b.](ii) the warrant, option, or convertible security is held in a discretionary account at the time of exercise or conversion, except where prior specific written approval for exercise or conversion is received from the customer;

[c.](iii) the arrangements whereby compensation is to be paid are not disclosed:

[1.].a. in the prospectus or offering circular by which the warrants, options, or convertible securities are offered to the public, if such arrangements are contemplated or any agreement exists as to such arrangements at that time, and

[2.].b. in the prospectus or offering circular provided to

security holders at the time of exercise or conversion; or
[d.](iv) the exercise or conversion of the warrants, options or convertible securities is not solicited by the underwriter or related person, provided however, that any request for exercise or conversion will be presumed to be unsolicited unless the customer states in writing that the transaction was solicited and designates in writing the broker/dealer to receive compensation for the exercise or conversion[;].

[(xiii)] (L) [f]For a member to participate with an issuer in the public distribution of a non-underwritten issue of securities if the issuer hires persons primarily for the purpose of distributing or assisting in the distribution of the issue, or for the purpose of assisting in any way in connection with the underwriting, except to the extent in compliance with 17 C.F.R. 240.3a4-1 and applicable state law.

[(xiv)] (M) [f]For a member or person associated with a member to participate in a public offering of real estate investment trust securities, as defined in Rule 2340(c)(4), unless the trustee will disclose in each annual report distributed to investors pursuant Section 13(a) of the Act a per share estimated value of the trust securities, the method by which it was developed, and the date of the data used to develop the estimated value.

[(C) In the event that the underwriter and related persons receive securities deemed to be underwriting compensation in an amount constituting unfair and unreasonable compensation pursuant to the stock numerical limitation in subparagraph (B)(ix) above, the recipient shall return any excess securities to the issuer or the source from which received at cost and without recourse, except that in exceptional and unusual circumstances, upon good cause shown, a different arrangement may be permitted.]

[(7)] (g) Lock-Up Restriction[s] on Securities

[(A) No member or person associated with a member shall participate in any public offering which does not comply with the following requirements:]

[(i) securities deemed to be underwriting compensation shall

not be sold, transferred, assigned, pledged or hypothecated by any person, except as provided in subparagraph (B) below, for a period of (a) one year following the effective date of the offering. However, securities deemed to be underwriting compensation may be transferred to any member participating in the offering and the bona fide officers or partners thereof and securities which are convertible into other types of securities or which may be exercised for the purchase of other securities may be so transferred, converted or exercised if all securities so transferred or received remain subject to the restrictions specified herein for the remainder of the initially applicable time period;]

[(ii) certificates or similar instruments representing securities restricted pursuant to subparagraph (i) above shall bear an appropriate legend describing the restriction and stating the time period for which the restriction is operative; and]

[(iii) securities to be received by a member as underwriting compensation shall only be issued to a member participating in the offering and the bona fide officers or partners thereof.]

(1) Lock-Up Restriction

In any public equity offering, other than a public equity offering by an issuer that can meet the requirements in subparagraphs (b)(7)(C)(i) or (ii) any common or preferred stock, options, warrants, and other equity securities of the issuer, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered and acquired by an underwriter and related person during 180 days prior to the required filing date, or acquired after the filing of the registration statement and deemed to be underwriting compensation by the NASD, and securities excluded from underwriting compensation pursuant to subparagraph (d)(5) above, shall not be sold during the offering, or 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 by any person for a period of 180

days immediately following the date of effectiveness or commencement of sales of the public offering, except as provided in subparagraph (g)(2) below.

(2) Exceptions to Lock-Up Restriction

[(B) The provisions of subparagraph (A) notwithstanding:]

Notwithstanding subparagraph (g)(1) above, the following shall not be prohibited:

(A) the transfer of any security:

(i) by operation of law or by reason of reorganization of the issuer [shall not be prohibited.];

(ii) to any member participating in the offering and the officers or partners thereof, if all securities so transferred remain subject to the lock-up restriction in subparagraph (g)(1) above for the remainder of the time period;

[(C) Venture capital restrictions. When a member participates in the initial public offering of an issuer's securities, such member or any officer, director, general partner, controlling shareholder or subsidiary of the member or subsidiary of such controlling shareholder or a member of the immediate family of such persons, who beneficially owns any securities of said issuer at the time of filing of the offering, shall not sell such securities during the offering or sell, transfer, assign or hypothecate such securities for ninety (90) days following the effective date of the offering unless:]

(i) the price at which the issue is to be distributed to the public is established at a price no higher than that recommended by a qualified independent underwriter who does not beneficially own 5% or more of the outstanding voting securities of the issuer, who shall also participate in the preparation of the registration statement and the prospectus, offering circular, or similar document and who shall exercise the usual standards of "due diligence" in respect thereto; or]

[(ii)] (iii) if the aggregate amount of [such] securities of the issuer held by [such a member and its related persons enumerated

above would] the underwriter or related person do not exceed 1% of the securities being offered[.];

(iv) that is beneficially owned on a pro-rata basis by all equity owners of an investment fund, provided that no participating member manages or otherwise directs investments by the fund, and participating members in the aggregate do not own more than 10% of the equity in the fund;

(v) that is not an item of value under subparagraphs (c)(3)(B)(iv) - (vii) above;

(vi) that is eligible for the limited filing requirement in subparagraph (b)(6)(A)(iv)b and has not been deemed to be underwriting compensation under the Rule;

(vii) that was previously but is no longer subject to the lock-up restriction in subparagraph (g)(1) above in connection with a prior public offering (or a lock-up restriction in the predecessor rule), provided that if the prior restricted period has not been completed, the security will continue to be subject to such prior restriction until it is completed; or

(viii) that was acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under SEC Rule 144A; or

(B) the exercise or conversion of any security, if all securities received remain subject to the lock-up restriction in subparagraph (g)(1) above for the remainder of the time period.

[(8)] (h) [Conflicts of Interest] Proceeds Directed to a Member[:]

(1) Compliance With Rule 2720

No member shall participate in a public offering of an issuer's securities where more than [ten (10) percent] 10% of the net offering proceeds, not including underwriting compensation, are intended to be paid to [members participating in the distribution of the offering or associated or affiliated persons of such members, or

members of the immediate family of such persons] participating members, unless the price at which an equity issue or the yield at which a debt issue is to be distributed to the public is established pursuant to Rule 2720(c)(3).

[(A)] (2) Disclosure

All offerings included within the scope of [this] subparagraph [(8)] (h)(1) shall disclose in the underwriting or plan of distribution section of the registration statement, offering circular or other similar document that the offering is being made pursuant to the provisions of this subparagraph and, where applicable, the name of the member acting as qualified independent underwriter, and that such member is assuming the responsibilities of acting as a qualified independent underwriter in pricing the offering and conducting due diligence.

[(B)] (3) Exception From Compliance

The provisions of [this] subparagraphs [(8)] (h)(1) and (2) shall not apply to:

[(i)] (A) an offering otherwise subject to the provisions of Rule 2720;

[(ii)] (B) an offering of securities exempt from registration with the Commission under Section 3(a)(4) of the Securities Act of 1933;

[(iii)] (C) an offering of a real estate investment trust as defined in Section 856 of the Internal Revenue Code; or

[(iv)] (D) an offering of securities subject to Rule 2810, unless the net offering proceeds are intended to be paid to the above persons for the purpose of repaying loans, advances or other types of financing utilized to acquire an interest in a pre-existing company.

[(d)] (i) Non-Cash Compensation

(1) Definitions

The terms "compensation," "non-cash compensation" and "offeror" as used in this Section (d) of this Rule shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of securities that is not

cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

(2) Restrictions on Non-Cash Compensation

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors¹ and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (d)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the

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

expenses of guests of the associated person; and

(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by subparagraph (d)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (d)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (d)(2)(C)-(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (d)(2)(C)-(E).

[e] (j) Exemptions

Pursuant to the Rule 9600 Series, the [Association may exempt a member or person associated with a member from the provisions of this Rule] appropriate NASD staff, 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.

2720. Distribution of Securities of Members and Affiliates – Conflicts of Interest

(a) General

No Change

(b) Definitions

(1) - (8) No Change

(9) Immediate family - the parents, mother-in-law, father-in-law, [husband or wife] spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or associated person of a member. In addition, the immediate family includes [or] any other person who [is supported, directly or indirectly, to a material extent by] either lives in the same household as, provides material support to, or receives material support from, an employee [of,] or associated person [associated, with] of a member.