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

File No. SR - 2007 - 009
Amendment No. 1

Proposed Rule Change 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)(2)
- ☐ 19b-4(f)(3)
- ☐ 19b-4(f)(4)
- ☐ 19b-4(f)(5)
- ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

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 proposed rule change.

First Name	Lisa	Last Name	Horrigan
Title	Associate General Counsel		
E-mail	lisa.horrigan@finra.org		
Telephone	(202) 728-8190	Fax	(202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 05/01/2009

By Gary L. Goldsholle
(Name)

Vice President and Associate General Counsel
(Title)

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

Gary Goldsholle,

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

Add Remove View

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

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

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Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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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

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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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 Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),[1] Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) is filing with the Securities and Exchange Commission ("SEC" or "Commission") this Amendment No. 1 to SR-FINRA-2007-009, a proposed rule change to modernize and simplify NASD Rule 2720 (Distributions of Securities of Members and Affiliates – Conflicts of Interest), which governs public offerings of securities in which a member with a conflict of interest participates and make corresponding changes to FINRA Rule 5110 (Corporate Financing Rule).

This Amendment No. 1 to SR-FINRA-2007-009 replaces and supersedes the original filing submitted on September 6, 2007, except with regard to Exhibit 2 (NASD Notice to Members 06-52 and comments received in response to NASD Notice to Members 06-52).

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on April 19, 2006, 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).

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

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

(a) Purpose

Background

FINRA is filing this Amendment No. 1 to SR-FINRA-2007-009 to make certain changes to the original filing of September 6, 2007 to address the Commission staff's comments.

NASD Rule 2720 governs public offerings of securities issued by participating members or their affiliates, public offerings in which a member or any of its associated persons or affiliates has a conflict of interest and public offerings that result in a member becoming a public company. The Rule regulates the potential conflicts of interest that exist with respect to the pricing of such offerings and the conduct of due diligence when a member participates in such offerings.

In September 2006, FINRA published NASD Notice to Members 06-52 requesting comment on proposed amendments to NASD Rule 2720 (the "original proposal"). FINRA received two comment letters that generally supported the proposal and recognized the need to modernize the Rule.[2] However, in response to the comments

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[2] Letter from the Securities Industry and Financial Markets Association, dated November 1, 2006 (the "SIFMA Letter"); and Letter from the American Bar Association, dated December 4, 2006 (the "ABA Letter").

received, FINRA staff made certain revisions to the proposal.

The proposed rule change would replace the current Rule in its entirety with proposed NASD Rule 2720 entitled "Public Offerings of Securities With Conflicts of Interest." Some of the more significant amendments that FINRA is proposing in this proposed rule change are to: (1) exempt from the filing and qualified independent underwriter ("QIU") requirements public offerings of investment grade rated securities, public offerings of securities that have a bona fide public market, and public offerings in which the member primarily responsible for managing the offering does not have a conflict of interest and can meet the disciplinary history requirements for a QIU; (2) amend the definition of "conflict of interest" to include public offerings in which at least five percent of the offering proceeds are directed to a participating member or its affiliates; (3) modify the Rule's disclosure requirements to provide more prominent disclosure of conflicts of interest in the offering documents; and (4) amend the Rule's provisions regarding the use of a QIU to focus on the QIU's due diligence responsibilities and eliminate the requirement that the QIU render a pricing opinion. In addition, the proposed rule change would amend the QIU qualification requirements to: (1) focus on the experience of the firm rather than its board of directors; (2) prohibit a member from acting as a QIU if it would receive more than five percent of the proceeds of an offering; and (3) lengthen from five to ten years the amount of time that a person involved in due diligence in a supervisory capacity must have a clean disciplinary history. These and the other proposed amendments are discussed in greater detail below.

Proposed NASD Rule 2720

Proposed Rule 2720(a) provides that no member that has a conflict of interest

may participate in a public offering unless the offering meets one of the exemptions set forth in paragraph (a)(1) or a QIU participates in the offering pursuant to paragraph (a)(2).

1. Offerings Exempt from the QIU and Filing Requirements under Paragraph (a)(1)

First, FINRA is proposing an exemption from the QIU and filing requirements for public offerings in which the member primarily responsible for managing the offering (e.g., the book-running lead manager or lead placement agent) does not have a conflict of interest, is not an affiliate of a member that has a conflict of interest, and can meet the disciplinary history requirements for a QIU under proposed paragraph (f)(12)(E). See proposed Rule 2720(a)(1)(A). FINRA staff believes that a QIU should not be required for such offerings because the book-running lead manager or lead placement agent (or member acting in a similar capacity), which does not have conflict of interest, would be expected to perform the necessary due diligence that would otherwise be required of a QIU.[3]

In response to comments on the original proposal,[4] FINRA has amended this provision to clarify that it applies to public offerings in which there are joint books or that are best efforts offerings. However, where there are two or more co-lead managers or co-lead placement agents that have equal responsibilities with regard to due diligence, each must be free of conflicts of interest. Due to the important role a book-runner or

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3 All syndicate members have due diligence responsibility, but the book-runner(s) in a firm commitment offering and the lead placement agent(s) in a best efforts offering typically hire outside counsel to help members meet their due diligence obligations.

4 SIFMA Letter.

dealer-manager can be expected to play in the due diligence process in an offering, even if that responsibility is shared equally with other members, the Rule's QIU provisions would apply, and the offering would have to be filed for review if any book-runner or dealer-manager has a conflict.

Second, FINRA is proposing an exemption from the QIU and filing requirements for public offerings of securities that have a bona fide public market. See proposed Rule 2720(a)(1)(B). The current Rule exempts public offerings of securities for which there is a "bona fide independent market"[5] from Rule 2720's QIU requirement, but not the filing requirement. The proposed rule change would replace the term "bona fide independent market" with "bona fide public market," which is defined in proposed Rule 2720(f)(3) in accordance with the numerical standards set forth in SEC's Regulation M under the Act.[6] Specifically, "bona fide public market" is defined as a market for a security issued by a company that has been reporting under the Exchange Act for at least 90 days, is current in its reporting requirements and whose securities are listed on a national securities exchange with an average daily trading volume of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million. One commenter expressed strong support for the proposed definition of "bona fide public market."[7]

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5 "Bona fide independent market" is defined in current Rule 2720(b)(3) as a market in a security that is listed on a national securities exchange or Nasdaq with a market price of $5 per share, aggregate trading volume of 500,000 shares over 90 days and a public float of 5 million shares.

6 17 CFR 242.100 to 105.

7 ABA Letter.

Third, FINRA is proposing to exempt from the filing requirement, and to retain the existing exemption from the QIU requirement for, public offerings of investment grade rated securities and securities in the same series that have equal rights and obligations as investment grade rated securities.[8] See proposed Rule 2720(a)(1)(C). In response to comments on the original proposal,[9] FINRA has proposed to define "investment grade rated" in proposed Rule 2720(f)(8) to refer to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories. This definition is consistent with the definition proposed by FINRA in SR-NASD-2004-022 relating to the filing requirements and the regulation of public offerings of securities registered with the Commission and offered by members pursuant to SEC Rule 415 (the "proposed shelf amendments").[10]

The three types of public offerings enumerated in paragraphs (a)(1)(A) through (a)(1)(C) of proposed Rule 2720 are not subject to the QIU requirements of the Rule and, by operation of proposed Rule 2720(d), they are not subject to the filing requirements of FINRA Rule 5110 (formerly NASD Rule 2710).[11] They are, however, subject to the

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8 Thus, proposed Rule 2720(a)(1)(C) would apply to public offerings of securities that have not received an individual rating, but are of the same class or series and are considered "pari passu" with other investment grade rated securities issued by the same company.

9 ABA Letter.

10 See Securities Exchange Act Release No. 50749 (November 29, 2004), 69 FR 70735 (December 7, 2004) (notice of filing of SR-NASD-2004-022) and Amendment No. 5 (filed on August 31, 2007), available at http://www.finra.org/Industry/Regulation/RuleFilings/2004/P036671.

11 On September 11, 2008, the SEC approved proposed rule change SR-FINRA-2008-039, in which FINRA proposed, among other things, to adopt NASD Rule 2710 as FINRA Rule 5110 in the Consolidated FINRA Rulebook. See Securities

other provisions of proposed Rule 2720, e.g., the escrow and discretionary account requirements in paragraphs (b) and (c) respectively, if applicable. Additionally, these public offerings are subject to certain disclosure requirements. Proposed Rule 2720(a)(1) requires prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering.

In response to the original proposal, one commenter requested clarification regarding the "prominent disclosure" requirement in the proposed Rule.[12] Proposed Rule 2720(f)(10) provides a description of how a member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B). Specifically, a member may make 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 provide such disclosures in the Plan of Distribution section required in Item 508 and any Prospectus Summary section required in Item 503 of SEC Regulation S-K. For offering documents not subject to SEC Regulation S-K, "prominent disclosure" may be made 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. These methods of disclosure are a non-exclusive safe harbor for effecting "prominent disclosure," and FINRA will consider alternative – but equally prominent – disclosures on a case-by-case basis.

Exchange Act Release No. 58514 (September 11, 2008), 73 FR 54190 (September 18, 2008) (order approving SR-FINRA-2008-039). SR-FINRA-2008-039 was implemented on December 15, 2008. See Regulatory Notice 08-57 (October 2008).

12 ABA Letter.

2. Offerings in Which a QIU Must Participate under Paragraph (a)(2)

If a member with a conflict of interest participates in a public offering that does not meet the conditions of proposed Rule 2720(a)(1), then pursuant to proposed Rule 2720(a)(2)(A), a QIU must participate in the preparation of the registration statement and the prospectus, offering circular or similar document and exercise the usual standards of "due diligence" with respect thereto.[13]

Like proposed Rule 2720(a)(1), proposed Rule 2720(a)(2)(B) requires "prominent disclosure," as defined in proposed Rule 2720(f)(10), in the prospectus, offering circular or similar document of the nature of the conflict of interest. In addition, proposed Rule 2720(a)(2)(B) requires disclosure of the name of the member acting as QIU and a brief statement regarding the role and responsibilities of the QIU. The disclosure requirements contained in current Rule 2720(d) require that, among other things, the offering documents expressly state that the member acting as QIU (if one is required for the offering) is assuming its responsibilities in pricing the offering and conducting due diligence. In response to commenters' concerns that such a statement potentially could give rise to liability on the part of the QIU,[14] FINRA is proposing to replace this disclosure requirement with a more general statement about the role and responsibilities of a QIU.

A public offering in which a QIU participates pursuant to proposed paragraph (a)(2) is subject to the filing requirements of Rule 5110. See proposed Rule 2720(d).

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13 The requisite qualifications of a QIU are set forth in the definition of "qualified independent underwriter" in proposed Rule 2720(f)(12), which is discussed in greater detail below.

14 ABA Letter; SIFMA Letter.

Additionally, a public offering in which a QIU participates must meet Rule 2720's escrow and discretionary account requirements, if applicable.

Current Rule 2720 requires that a QIU provide an opinion that the price at which equity securities are offered to the public is no higher, or the yield for debt securities is no lower, than that recommended by the QIU. The proposed rule change would eliminate the requirement that a QIU provide a pricing opinion. FINRA staff is unaware of instances where QIUs have made recommendations that were inconsistent with pricing decisions by the book-running lead manager or lead placement agent. In addition, FINRA staff believes that QIU pricing opinions in at-the-market offerings are of little to no value. Both commenters expressed strong support for eliminating the QIU pricing requirement.[15]

3. Escrow of Proceeds; Net Capital Computation

Proposed Rule 2720(b)(1) requires that all proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with the net capital requirements set forth in paragraph (b)(2). This proposed provision mirrors current Rule 2720(e).[16]

The net capital requirements set forth in proposed Rule 2720(b)(2) mirror current Rule 2720(e)(2), except that FINRA is proposing to replace the reference to SEC Rule 15c3-1(f) with a reference in proposed Rule 2720(b)(2) to the alternative standard for

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15 ABA Letter; SIFMA Letter.

16 Members are reminded that additional escrow account maintenance and payment requirements may be applicable under SEC Rule 15c2-4.

calculating net capital under SEC Rule 15c3-1(a)(1)(ii).

In addition, proposed Rule 2720(b)(3) provides that 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). This provision mirrors current Rule 2720(d)(1).

4. Disclosure

Current Rule 2720(d)(1) requires disclosure in the registration statement or offering circular regarding the date the offering will be completed and the terms upon which proceeds will be released from the escrow account. Current Rule 2720(d)(2) requires disclosure: (1) that the offering is being made pursuant to Rule 2720; (2) relating to the member's status in the offering; and (3) relating to the QIU (if one is required).

The proposed rule change would delete current paragraph (d) of Rule 2720 and, as discussed above, move the disclosure requirements in current paragraph (d)(1) to proposed paragraph (b)(3), and establish separate disclosure requirements for public offerings in which a QIU participates (see proposed Rule 2720(a)(2)(B)) and public offerings in which a QIU does not participate (see proposed Rule 2720(a)(1)).

5. Discretionary Accounts

Proposed Rule 2720(c) provides that, notwithstanding 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. This provision differs from current Rule 2720 in that FINRA has narrowed the proposed Rule to apply only to the sale of securities by the member with the conflict of interest, rather than limit discretionary sales by all firms participating in the offering, even those that do not have a conflict of interest. One commenter expressed support for limiting this provision to the member that has a conflict.[17] Additionally, FINRA notes that the "specific written approval" requirement in this provision can be satisfied by an email from the customer.

6. Application of Rule 5110

As noted above, proposed Rule 2720(d) provides that any public offering subject to the QIU requirements of paragraph (a)(2) is subject to Rule 5110, whether or not the offering would otherwise be exempted from that Rule's filing or other requirements. Rule 5110 generally requires members to file with FINRA public offerings for review of the proposed underwriting terms and arrangements. Rule 5110 contains certain exemptions from the filing requirements for, among others, public offerings of the securities of seasoned issuers[18] and offerings of investment grade debt. However, pursuant to current Rule 2720(m), these exemptions are inapplicable to public offerings that fall within the scope of Rule 2720. Thus, for example, while a public offering of the securities of a seasoned issuer is normally exempt from filing under Rule 5110, if a

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17 ABA Letter.

18 The "seasoned issuer" filing exemption in Rule 5110(b)(7)(C) currently exempts offerings registered on Forms S-3 and F-3 by issuers that meet the standards for those Forms prior to October 21, 1992 (i.e., a three-year reporting history and either $150 million float or $100 million float and annual trading volume of three million shares). The proposed shelf amendments (see supra note 10) would preserve the current filing requirements and amend the Rule to specifically describe the pre-October 21, 1992 standards.

member participating in the offering has a conflict of interest with the seasoned issuer, it must be filed and comply with Rule 5110. The proposed rule change narrows this filing requirement to apply only to those public offerings that fall within the scope of proposed Rule 2720(a)(2).

In response to comments on the original proposal,[19] FINRA is proposing to amend current Rule 5110(b)(7), which lists offerings that are exempt from the Rule 5110 filing requirements, to specify that documents and information related to the public offerings listed in Rule 5110(b)(7) are not required to be filed with FINRA for review, unless the public offering is subject to the QIU requirements of Rule 2720(a)(2). This would clarify that if a public offering listed in Rule 5110(b)(7) is subject to Rule 2720(a)(1), such offering would not be subject to the filing requirements of Rule 5110.

7. Requests for Exemption from Rule 2720

Proposed Rule 2720(e) provides that pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate. This provision mirrors existing Rule 2720(o).

8. Definition of "Affiliate"

Proposed Rule 2720(f)(1) defines the term "affiliate" as an entity that controls, is controlled by or is under common control with a member. While current Rule 2720(b)(1) incorporates the "control" standard in the definition of affiliate, FINRA is proposing instead to adopt a separate definition of "control," which is discussed below.

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19 SIFMA Letter.

In response to comments on the original proposal,[20] FINRA has narrowed the proposed definition of "affiliate" to apply only where an entity controls, is controlled by or is under common control with a member. As originally proposed, the definition would have applied where an entity was under common control with another entity that controls, was controlled by or was under common control with a member.

9. Definition of "Beneficial Ownership"

Proposed Rule 2720(f)(2) defines "beneficial ownership" as the right to the economic benefits of a security. This provision mirrors the definition contained in current Rule 2720(b)(2). In NASD Notice to Members 06-52, FINRA requested comment on whether Rule 2720 should incorporate the definition of "beneficial ownership" found in SEC Rule 13d-3. That definition includes the right to dispose and vote the securities, which would apply to many investment funds. In response to comments suggesting that the definition should be confined to economic interests in which the member can profit directly,[21] FINRA is proposing to retain the current definition of "beneficial ownership."

10. Definition of "Common Equity"

Proposed Rule 2720(f)(4) defines "common equity" as 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. This definition mirrors current Rule 2720(b)(5).

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20 ABA Letter.

21 ABA Letter.

11. Definition of "Conflict of Interest"

Proposed Rule 2720(f)(5) would define "conflict of interest" to mean, if at the time of a member's participation in an entity's public offering, any of four conditions applies. The Rule would operate much as it does today; however, the proposed rule change would relocate many of the current Rule's substantive concepts to the definition of "conflict of interest."

First, pursuant to proposed Rule 2720(f)(5)(A), a conflict of interest would exist if the securities are to be issued by the member.

Second, pursuant to proposed Rule 2720(f)(5)(B), a conflict of interest would exist if the issuer controls, is controlled by or is under common control with the member or the member's associated persons. "Control" is defined in proposed Rule 2720(f)(6) and is discussed below.

Third, pursuant to proposed Rule 2720(f)(5)(C), a conflict of interest would exist where at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be: (i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or (ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate. In response to comments on the original proposal,[22] FINRA has amended the proposed definition to clarify that the proceeds are net of underwriting compensation.

Currently, Rule 5110(h) requires public offerings in which ten percent or more of

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22 SIFMA Letter.

the offering proceeds (not including the underwriting discount) will be paid to participating members to comply with Rule 2720's QIU requirements. Pursuant to this proposed rule change, FINRA is proposing to delete Rule 5110(h) and move the proceeds requirement to Rule 2720 by defining "conflict of interest" to include a member's participation in a public offering where proceeds are directed to the member. Although the threshold for proceeds directed to a member is being lowered from ten percent to five percent, the new threshold would apply to each participating member individually (including the member's affiliates and its associated persons), not on an aggregate basis for all participating members, as is currently the case. Thus, for example, a conflict of interest would exist where a member received five percent of the proceeds, but not where two unaffiliated members each received three percent of the proceeds.

Fourth, pursuant to proposed Rule 2720(f)(5)(D), a conflict of interest would exist if, as a result of the public offering and any transactions contemplated at the time of the public offering: (i) the member will be an affiliate of the issuer; (ii) the member will become publicly owned; or (iii) the issuer will become a member or form a broker-dealer subsidiary.

In response to comments on the original proposal,[23] FINRA is clarifying that for purposes of Rule 2720, "participation in a public offering" has the same meaning as in Rule 5110. Rule 5110(a)(5) provides that "participation or participating in a public offering" means "participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or

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23 SIFMA Letter.

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 SEA Rule 13e-3."[24]

12. Definition of "Control"

As noted above, under the current Rule, the control standard is incorporated in the definition of "affiliate." The proposed rule change would instead adopt the following definition of "control:" (i) beneficial ownership[25] of ten percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member's participation in the public offering; (ii) the right to ten percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering; (iii) beneficial ownership of ten percent or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member's participation in the public offering; (iv) beneficial ownership of ten percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or (v) the power to direct or cause the

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[24] Pursuant to the proposed shelf amendments (see supra note 10), Rule 5110(a)(5) would be amended to specify participation in the distribution of the offering on an "underwritten, non-underwritten, principal, agency or any other basis" and to include "participation in a shelf takedown" in this definition.

[25] The term "beneficial ownership" is defined in proposed paragraph (f)(2). In response to a comment by Commission staff, FINRA is clarifying that the use of that term in proposed paragraph (f)(6) is a more narrow interpretation of the term owing to the numerical thresholds imposed by this subparagraph.

direction of the management or policies of an entity. See proposed Rule 2720(f)(6)(A). FINRA believes it is important in subparagraph (i) to include entities other than corporations, to expressly include conflicts that may arise in connection with the offerings of, for example, trusts.

In its original proposal and the original filing of September 6, 2007, FINRA proposed that the definition of control would eliminate ownership of subordinated debt and preferred equity as a basis for a conflict of interest.[26] However, in response to comments from Commission staff, FINRA is proposing in this Amendment No. 1 to include beneficial ownership of ten percent or more of the outstanding common equity (which is defined expressly to include non-voting stock), subordinated debt or preferred equity in the proposed definition of control. Thus, for example, "control" could derive from the restrictive covenants typically found in debt indentures, preferred rights to dividends given to holders of non-voting common or preferred stock or special voting rights given to certain classes of (generally) non-voting stock. FINRA is specifically requesting comment on whether such forms of ownership give rise to a conflict of interest and should be included in the proposed Rule.

The proposed definition of control includes not only shares beneficially owned by a participating member, but also the right to receive such securities within 60 days of the member's participation in the public offering. In its original filing of September 6, 2007, FINRA proposed that for purposes of this provision, 60 days would be from the effective date of the offering. However, in this Amendment No. 1, FINRA is revising the

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[26] See current Rule 2720(b)(7)(A) and (C).

proposed rule text to provide that the relevant time frame is "within 60 days of the member's participation in the public offering."[27] This will ensure that the Rule properly applies to takedowns from an effective shelf registration. FINRA believes that the determination of control should be when the member participates in an offering, not the date that a registration statement for the offering is declared effective.

Thus, under the proposed rule change, warrants or rights for voting securities that are exercisable within 60 days of the member's participation in the public offering would be included in the calculation of voting securities when determining whether control exists. In response to comments on the original proposal, FINRA is clarifying that in calculating the percentage beneficial ownership, it is appropriate to include the potential ownership of shares in both the numerator and denominator.[28] FINRA does not believe, however, that this calculation should include securities that could be received by all investors. Rather, the calculation is limited to warrants or rights that are exercisable within 60 days and received by the participating member only and would not include warrants or rights held by other investors.

13. Definition of "Entity"

Currently, Rule 2720 does not contain a definition of "entity." Pursuant to proposed Rule 2720(f)(7), an "entity" would be defined, for purposes of the definitions of affiliate, conflict of interest and control under the Rule, as "a company, corporation,

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27 See supra page 17 for a discussion of the definition of the term "participation in a public offering."

28 See ABA Letter (requesting that FINRA clarify whether the amount of securities to be received by a member and any other person within 60 days of the offering will be included in the denominator in order to calculate the member's total ownership interest in the issuer's securities).

partnership, trust, sole proprietorship, association or organized group of persons."

The proposed definition would expressly exclude: (i) an investment company registered under the Investment Company Act of 1940; (ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act of 1940; (iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code; and (iv) a "direct participation program" as defined in NASD Rule 2810. These exclusions are substantially similar to the exemptions from the "conflict of interest" provisions contained in current Rule 2720(b)(7)(D). In response to comments on the original proposal,[29] FINRA revised the proposed definition of "conflict of interest" to apply only to a public offering of an "entity."

14. Definition of "Preferred Equity"

Proposed Rule 2720(f)(9) defines the term "preferred equity" as the aggregate capital invested by all persons in the preferred securities 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. This definition mirrors current Rule 2720(b)(12).

15. Definition of "Public Offering"

Proposed Rule 2720(f)(11) essentially mirrors the definition of "public offering" in current Rule 2720(b)(14) and would define the term as any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or

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[29] SIFMA Letter.

acquisition and all other securities offerings of any kind whatsoever. The proposed definition excludes from its scope any offering made pursuant to: (i) an exemption from registration under Sections 4(1), 4(2) or 4(6) of the Securities Act of 1933;[30] and (ii) SEC Rule 504, if the securities are "restricted securities" under SEC Rule 144(a)(3), SEC Rules 505 or 506. FINRA currently does not interpret an offering made pursuant to SEC Regulation S to be within the scope of a "public offering" under this Rule and as such, is proposing also to exclude these offerings from the definition. Additionally, in response to comments on the original proposal,[31] FINRA has amended the proposed definition of "public offering" to expressly exclude exempted securities as defined in Section 3(a)(12) of the Exchange Act,[32] as in the current Rule.

One commenter suggested that the proposed Rule should provide an express exclusion for offerings made pursuant to SEC Rule 144A.[33] FINRA agrees and has added an express exclusion for offerings under SEC Rule 144A.[34] FINRA also notes that it currently does not interpret an offering made pursuant to SEC Rule 144A to be within the scope of either Rule 5110 or Rule 2720.

16. Definition of "Qualified Independent Underwriter"

Proposed Rule 2720(f)(12) defines the term "qualified independent underwriter" as a member that meets the following conditions. First, the member must not have a

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30 15 U.S.C. 77d(1), (2) or (6).

31 ABA Letter.

32 15 U.S.C. 78c(a)(12).

33 ABA Letter.

34 See Securities Act Release No. 6862, 55 FR 17933 (April 30, 1990) (File No. S7-23-88).

conflict of interest and must not be an affiliate of any member that has a conflict of interest. See proposed Rule 2720(f)(12)(A). The Rule currently does not disqualify or prohibit a QIU from receiving proceeds from an offering. The proposed rule change would prohibit a QIU from receiving more than five percent of the offering proceeds because the receipt of such proceeds would disqualify a member from acting as a QIU because it would fall within the proposed definition of "conflict of interest."

Second, the member cannot beneficially own, as of the date of the member's participation in the public offering, more than five percent 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. See proposed Rule 2720(f)(12)(B). Current Rule 2720(b)(15)(E) prohibits a member from acting as a QIU if it is an affiliate of the issuer or if it beneficially owns at least five percent of the equity, subordinated debt or partnership interest of the issuer. The proposed rule change would maintain these prohibitions.

Third, the member must have agreed, in acting as a QIU, to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in Section 11 thereof.[35] See proposed Rule 2720(f)(12)(C). The proposed provision mirrors current Rule 2720(b)(15)(F).

Fourth, the member must have 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 for which

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35 15 U.S.C. 77k.

there is no 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. See proposed Rule 2720(f)(12)(D). FINRA is specifically requesting comment on whether the 50% threshold should be lowered if an equity offering is particularly large (e.g., over $1 billion). The proposed requirements mirror those set forth in current Rule 2720(b)(15)(C), except that currently, the relevant period is five years. In addition to shortening this period to three years, the proposed rule change also would impose, as discussed above, the requirement that a QIU must have acted as a managing underwriter in at least three similar offerings during that time.

Additionally, Rule 2720(b)(15)(B) currently permits a member to serve as a QIU only if the member: (i) is a sole proprietorship and the sole proprietor has been actively engaged in the investment banking or securities business for the five-year period immediately preceding the filing of the registration statement, or (ii) is a corporation or partnership and a majority of its board of directors or general partners has been similarly engaged in the investment banking or securities business. The proposed rule change would eliminate the requirement regarding board or partner experience, since FINRA

staff believes that the experience of the firm is more relevant.

Finally, none of the member's associated persons in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities shall: (i) have 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) be 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) have been suspended or barred from association with any member by an order or decision of the Commission, 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. See proposed Rule 2720(f)(12)(E). The Rule currently prohibits an associated person's involvement in the due diligence process in a supervisory capacity

if that person has been subject to certain criminal and disciplinary actions pertaining to the offering of securities within five years prior to the filing of the registration statement. The proposed rule change, as described above, would lengthen this period from five to ten years.

17. Definition of "Registration Statement"

Proposed Rule 2720(f)(13) defines the term "registration statement" as a registration statement as defined by Section 2(a)(8) of the Securities Act of 1933;[36] notification on Form 1A filed with the Commission pursuant to the provisions of SEC Rule 252 under the Securities Act of 1933; 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. This definition mirrors current Rule 2720(b)(16), except for technical changes to correct the references in the current Rule to Section 2(8) of the Securities Act and SEC Rule 255.

18. Definition of "Subordinated Debt"

Proposed Rule 2720(f)(14) defines "subordinated debt" to include (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. This definition mirrors current Rule 2720(b)(18).

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[36] 15 U.S.C. 77b(a)(8).

19. Deleted Definitions

Proposed Rule 2720 does not contain the following definitions that appear in current Rule 2720: company, effective date, immediate family, parent, person, public director and settlement. In response to comments on the original proposal,[37] FINRA is proposing to adopt the current definitions of company, effective date, immediate family and person as new paragraphs (a)(11) through (14) of Rule 5110 because they are used in that Rule.[38] Proposed Rule 2720(f) provides that the definitions in Rule 5110 are incorporated by reference in Rule 2720.

17. Corporate Governance and Periodic Reporting

Rule 2720 currently includes certain provisions that do not apply to the public offering itself and instead require the issuer to adopt corporate governance policies relating to an audit committee and public directors and to issue periodic reports to shareholders.[39] With the enactment of the Sarbanes-Oxley Act and recent SEC rulemaking and interpretive actions, issuers' periodic reporting requirements under the Exchange Act have been enhanced and listing standard changes intended to improve corporate governance and enhance the role of audit committees have been adopted. Accordingly, at this time, FINRA believes that separate Rule 2720 requirements for corporate governance and periodic reporting are unnecessary. One commenter expressed

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37 ABA Letter.

38 Pursuant to the proposed shelf amendments, FINRA proposed to adopt certain new definitions as paragraphs (a)(11) through (14) of Rule 5110. See supra note 10. This proposed rule change is not intended to supersede those proposed amendments.

39 See paragraphs (f), (g) and (h) of current Rule 2720.

support for eliminating these provisions from Rule 2720.[40]

18. Intrastate Offerings

Rule 2720(j) currently requires any member offering its securities pursuant to the intrastate offering exemption under the Securities Act to include in the offering documents information required in a release that the SEC published in 1972. The proposed amendments would delete this requirement from Rule 2720. FINRA believes that disclosure requirements for unregistered offerings should be addressed in a more comprehensive manner by the SEC, the states or FINRA, and not imposed under the narrow scope of Rule 2720 or limited to intrastate offerings. One commenter suggested that FINRA should not adopt disclosure requirements for intrastate offerings because such offerings are subject to the disclosure requirements of the state where the securities are offered.[41]

19. Suitability

Rule 2720(k) currently requires that every member underwriting an issue of its own securities, or securities of an affiliate or company with which it has a conflict of interest that recommends to a customer the purchase of a security of such issue must have reasonable grounds to believe that the recommendation is suitable for the customer. FINRA is not proposing a similar provision in new Rule 2720 because NASD Rule 2310 already addresses a member's obligations relating to suitability.

As noted in Item 2 of this filing, FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days

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40 ABA Letter.

41 ABA Letter.

following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[42] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will simplify and modernize Rule 2720, thereby providing greater clarity regarding members' obligations and enhancing the regulation of public offerings in which members have a conflict of interest.

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

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

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

The proposed rule change was published for comment in NASD Notice to Members 06-52 (September 2006). Two comments were received in response to the Notice. A copy of the Notice is attached as Exhibit 2a. A list of the comment letters received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. Those comments

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[42] 15 U.S.C. 78o–3(b)(6).

that have not already been addressed herein are discussed below.[43]

Comments on the Scope of Proposed Rule 2720

Both commenters suggested revising proposed Rule 2720(a)(1) to include additional categories of public offerings that would be exempt from the QIU and filing requirements by operation of proposed Rule 2720(d). As discussed in greater detail below, FINRA does not agree that the exemptions should be expanded further. FINRA notes that, as proposed, the Rule would significantly reduce the number of public offerings that must be filed and reviewed by FINRA staff. A public offering (that is not an offering of investment grade rated securities or securities with a bona fide public market) will be subject to the QIU and filing requirements under Rule 2720 only if a member with primary responsibility for managing the offering has a conflict of interest. As such, FINRA does not believe that it would be appropriate to further expand the automatic exemptions under the Rule, as suggested by the commenters.

Specifically, the commenters suggested that paragraph (a)(1) of the proposed Rule should include "well-known seasoned issuers" or "WKSIs."[44] The commenters contend that such a change would be consistent with the proposed shelf amendments, which

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43 In addition, FINRA has incorporated some of the commenters' non-substantive comments without specifically addressing them herein, e.g., comments regarding inconsistent use of the terms "entity," "company" and "issuer." See ABA Letter.

44 ABA Letter; SIFMA Letter.

Pursuant to amendments to SEC rules governing shelf offerings, which became effective on December 1, 2005, WKSIs are defined as S-3 eligible issuers that have either $700 million of worldwide equity market capitalization or an aggregate $1 billion of non-convertible securities issued within the past three years. See Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722 (August 3, 2005) (SEC File No. S7-38-04).

would exempt all WKSI shelf offerings from the filing requirements of Rule 5110.[45] FINRA does not agree. FINRA believes that if a participating member has a conflict of interest, the offering should be subject to the QIU and filing requirements, irrespective of whether the issuer involved is a WKSI. Today, a WKSI that is not required to file under Rule 5110 would nonetheless be required to obtain a QIU if it were to receive ten percent of the offering proceeds. See current Rules 5110(h) and 2720(m). In addition, FINRA does not agree that application of Rule 2720 to WKSIs would slow the offering process.[46]

Currently, all WKSI filings are reviewed and cleared on the same day they are received by FINRA's Corporate Financing Department. In connection with the proposed shelf amendments, FINRA is developing upgrades to the COBRADesk electronic filing system that will implement a new same-day automatic review and clearance process for most shelf offerings and all WKSI shelf offerings.[47]

Similarly, one commenter suggested that public offerings by issuers with investment grade rated debt, which are currently exempted by Rule 5110(b)(7)(A), should be included in proposed Rule 2720(a)(1).[48] FINRA does not agree. The proposed rule change is designed to focus on the particular public offering in which a member has a conflict of interest. FINRA believes that while it is appropriate to exempt certain public offerings from the Rule, it would be inappropriate to exempt an entire class of

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45 ABA Letter; SIFMA Letter.

46 SIFMA Letter.

47 See supra note 10.

48 SIFMA Letter.

issuers such as WKSIs or all issuers with investment grade rated debt. The relevant inquiry is whether the member has a conflict of interest with respect to that offering of that security; the characteristics of the issuer should not be determinative. As such, FINRA also does not agree with the commenter that proposed paragraphs (a)(1)(B) and (C) should be amended to refer to the issuer of the securities, instead of the securities being offered.[49]

One commenter suggested that the exception under proposed Rule 2720(a)(1)(B) should be available for public offerings of warrants, options, convertible debt and convertible preferred securities that are exercisable for or convertible into equity securities that meet the standard of having a bona fide public market.[50] FINRA does not believe that such an exemption would be appropriate because the characteristics of the derivative will not always be the same as the underlying security. The existence of a bona fide public market in the underlying equity security does not necessarily extend to an offering of a derivative on that security.

One commenter also suggested that there should be an exception for offerings by banks and other financial institutions that are the parents or affiliates of FINRA members of medium-term notes or similar securities, the return of which is linked to the performance of a particular stock, asset or index.[51] While an offering of these securities that are rated investment grade would be exempted under the proposed Rule, FINRA believes that an offering of such securities rated below investment grade should continue

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49 SIFMA Letter.

50 ABA Letter.

51 ABA Letter.

to be subject to the filing and QIU requirements. FINRA believes that an exemption for offerings of structured products rated below investment grade would be inconsistent with concerns expressed by FINRA about these securities.[52] However, to avoid potential unintended consequences of the proposed Rule, FINRA is specifically requesting comment on whether certain other types of securities that are registered on a shelf registration statement or automatic shelf registration statement should be eligible for the exemption from the filing and QIU requirements.

Both commenters suggested that the reorganizations, mergers and acquisition transactions that are currently exempted by Rule 2720(a)(3) should be exempted under proposed Rule 2720(a)(1).[53] FINRA believes that unless a reorganization, merger or acquisition would otherwise meet the proposed Rule 2720(a)(1) exemptions, it should be subject to the QIU and filing requirements. The Rule currently applies to these transactions if the member or its parent issues shares or the transaction results in the public ownership of a member. Thus, there is not currently a blanket exemption for reorganizations, mergers and acquisitions.

One commenter also suggested that the proposed Rule should exempt all offerings

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52 See NASD Notice to Members 05-59 (September 2005). The Notice stated that FINRA is concerned that when members sell structured products, they may not be fulfilling their sales practice obligations, including the requirement to perform a reasonable-basis and customer-specific suitability determination. The Notice also raised specific concerns about member sales practice obligations when selling these instruments to retail customers. The Notice added that structured products have been increasingly targeted at retail investors and that FINRA is concerned about the manner in which such products are marketed and the types of investors purchasing such products.

53 ABA Letter; SIFMA Letter.

by government entities.[54] FINRA has proposed to exclude certain government entities from the filing requirements of Rule 5110 pursuant to the proposed shelf amendments;[55] however, FINRA does not agree that all such offerings should be excluded under Rule 2720. If a member has a conflict of interest with a government entity (e.g., the member will receive at least five percent of the net proceeds of the public offering) and the public offering does not otherwise meet the Rule 2720(a)(1) exemptions, FINRA believes that the offering documents should be filed and reviewed by FINRA staff.

One commenter suggested that offerings of securities exempt from registration with the Commission under Section 3(a)(4) of the Securities Act of 1933 should be exempt under proposed Rule 2720(a)(1), noting that such offerings currently are exempted from the conflict of interest provisions of Rule 2720.[56] While FINRA is not aware of member conflicts with non-profit or charitable organizations, in the unlikely event that such a conflict does exist, FINRA believes that the offering should be filed and reviewed by FINRA staff.

This same commenter also suggested that proposed Rule 2720(a)(1) should exclude offerings conducted pursuant to the multi-jurisdictional disclosure system because they are already subject to regulation under the Canadian system.[57] FINRA does not agree that it should remove itself from public offerings in which a FINRA member with a conflict of interest is participating, even if such offerings also are subject to

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54 SIFMA Letter.

55 See supra note 10.

56 SIFMA Letter.

57 SIFMA Letter.

regulation under the Canadian system.

Finally, with respect to proposed Rule 2720(a)(1)(A), one commenter suggested amending the provision to apply to any book-running manager, including co- or joint book-running managers, such that a QIU would not be required if any of the joint book-runners could meet the requirements of the Rule.[58] FINRA does not agree that the provision should be expanded in this way. FINRA understands that in some joint book offerings, members have been designated as a joint book-runner or co-lead manager in return for assistance with the road show or other services critical to marketing the offering. In some cases, the member designated as a co-lead would not be in the position of supervising due diligence for the offering or may not be involved in the due diligence at all. FINRA staff does not believe that including a book-runner or lead placement agent without a conflict of interest eliminates the conflict that exists with respect to the remaining book-runner(s) or lead placement agent(s). Therefore, amending the proposed provision as the commenter suggests would not fulfill the objective of ensuring independent due diligence by a member free of conflicts.

Comments on Proposed QIU Requirements

One commenter suggested that the references to "due diligence" and "usual standards of due diligence" should be eliminated from the Rule, expressing concern that such references could raise the due diligence defense to the level of a regulatory requirement.[59] The requirement that a QIU exercise the usual standards of due diligence has been in the Rule for 20 years (see, e.g., current Rule 2720(c)(3)(A) and (d)(2)) and

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58 SIFMA Letter.

59 SIFMA Letter.

FINRA believes that it is an appropriate regulatory requirement. However, as discussed above, in response to comments, as well as similar concerns expressed by FINRA's Corporate Financing Committee, FINRA has eliminated the proposal to require that the offering documents include a statement that the QIU has assumed responsibilities for conducting due diligence.

The commenters also suggested that offerings in which a QIU participates should be exempt from the filing requirements of Rule 5110.[60] FINRA does not believe that the participation of a QIU in an offering sufficiently mitigates the conflicts of interest such that FINRA review is no longer necessary. Additionally, pursuant to current Rule 2720(m), the Rule 5110 filing requirements apply to all public offerings subject to Rule 2720, including public offerings in which a QIU has participated. Thus, the proposed rule change would not expand the current filing requirements.

Comments on the Proposed Discretionary Accounts Provision

One commenter[61] suggested that the Rule should be revised to incorporate the advance authorization procedure in FINRA's Corporate Financing Department's exemption letter to Goldman Sachs (the "Goldman Letter").[62] The Goldman Letter applies to public offerings of straight debt securities, structured notes and straight preferred stock issued by Goldman or its affiliates and permits the firm to use an advance authorization procedure in lieu of the requirement in Rule 2720 for prior specific written

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60 ABA Letter; SIFMA Letter.

61 ABA Letter.

62 See letter to Judith G. Belash, Esq., Goldman, Sachs & Co., from Joseph Price, NASD, Corporate Financing Department, dated June 14, 1999, available at http://www.finra.org/Industry/Regulation/Guidance/ExemptiveLetters/P002617.

approval. Specifically, the firm could obtain an advance written letter of consent from certain customers with discretionary accounts and oral authorization by the customer prior to execution of the transaction. FINRA does not believe that Rule 2720 should expressly incorporate the advance authorization procedure set forth in the Goldman Letter. As discussed above, the written authorization requirements of this provision can be satisfied by email, which today may often prove quicker and easier than obtaining oral authorization.

Additionally, this commenter suggested that public offerings in which proceeds are being directed to a member should be exempted from the discretionary account provision.[63] FINRA does not agree. FINRA believes that the receipt of offering proceeds by members and their affiliates gives rise to conflicts that are of equal concern in the context of sales to a discretionary account.

Comments on the Proposed Definition of "Affiliate"

One commenter suggested that the definition of "affiliate" should be structured similar to the current definition as a control standard and a presumption of control as a result of management or share ownership.[64] FINRA recognizes that there are other ways to define "affiliate"; however, this commenter has not demonstrated that its recommended approach is better than the approach FINRA is proposing.

Comments on the Proposed Definition of "Bona Fide Public Market"

The commenters suggested that the definition of "bona fide public market" should be amended to apply to equity securities of foreign issuers that meet the "actively traded"

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63 ABA Letter.

64 ABA Letter.

standards of SEC Regulation M and are designated offshore securities markets under Rule 902(b).[65] Upon further consideration, FINRA is not proposing to amend the definition along these lines. Because securities with a bona fide public market are not subject to the QIU or filing requirements, amending the definition to apply to securities traded on a foreign market would make this exemption too broad.

One commenter also suggested that the definition should be amended to clarify that the issuer – and not the particular security – must have a bona fide public market.[66] FINRA does not agree. As discussed above, the focus of this Rule is on the securities being offered and not the characteristics of the issuer.

Comments on the Proposed Definition of "Conflict of Interest"

The commenters suggested that there should be no filing requirement for public offerings in which the conflict of interest derives from the member's receipt of proceeds.[67] One commenter asserted that "NASD has historically deemed a conflict of interest based on the receipt of offering proceeds by participating members to be a less significant conflict than one that is based on the ownership of an issuer's securities or management control."[68] FINRA does not agree and believes that the conflict deriving from a member's receipt of proceeds warrants review and filing of the offering documents. Indeed, FINRA's Corporate Financing Committee has identified conflicts resulting from proceeds being directed to a member as one of the most important

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65 ABA Letter; SIFMA Letter.

66 SIFMA Letter.

67 ABA Letter; SIFMA Letter.

68 ABA Letter.

conflicts in public offerings today. Pursuant to the proposed rule change, all public offerings in which a QIU is involved – including those for which a QIU is required because proceeds are being directed to a member or its affiliate – must be filed and reviewed by FINRA staff.

Additionally, both commenters assert that the five percent threshold for a member's receipt of offering proceeds is too low.[69] FINRA does not agree and believes that in recognition of the significance of proceeds-related conflicts, it is appropriate to lower the threshold from ten percent to five percent.

One commenter suggested that the proposed definition of "conflict of interest" should exclude transactions by which the issuer will become a member or form a broker-dealer subsidiary.[70] This commenter also suggested that the definition be revised to exclude reorganizations and restructurings if no material change in the ownership of the issuer or participating member is taking place.[71] FINRA does not agree that merely because the corporate governance provisions have been deleted from the Rule, a member's participation in such offerings no longer creates a conflict of interest. FINRA believes that these offerings should be subject to the Rule.

This commenter also suggested that the old formulation in which conflicts of interest existed under specific circumstances, rather than as a result of a member's participation in public offerings where certain conditions apply, should be retained

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69 ABA Letter; SIFMA Letter.

70 SIFMA Letter.

71 SIFMA Letter.

because it was easier for members to argue that no conflict actually exists.[72] FINRA does not agree and believes that the proposed definition of "conflicts of interest" is preferable in that it clearly delineates the scope of the Rule.

The commenters suggested that the definition should not apply to arms length forward sales contracts and other derivatives where the proceeds are used by the issuer to purchase the securities to hedge risk in the transactions.[73] FINRA is requesting further comment on this issue and specifically how use of the proceeds by the issuer to buy derivatives or other hedging transactions is substantially different from other uses of proceeds contemplated by the Rule (e.g., to retire debt).

Comments on the Proposed Definition of "Control"

One commenter suggested that "control" should not be a defined term because an entity that is in a control relationship is an affiliate and thus, the control concept should remain in the definition of "affiliate."[74] As previously noted, FINRA recognizes that there are other ways to approach the definitions and standards set forth in this Rule. However, FINRA does not believe that the approach the commenter has proposed is preferable to that outlined above.

Comments on the Proposed Definition of "Entity"

One commenter suggested that the proposed definition of "entity" be amended to include groups of persons only if they are organized to conduct business under the laws

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72 SIFMA Letter.

73 ABA Letter; SIFMA Letter.

74 ABA Letter.

of a jurisdiction.[75] FINRA does not agree and believes that more flexibility is needed given that FINRA is not proposing to define "beneficial ownership" in accordance with SEC Rule 13d-3.

Comments on the Proposed Definition of "Public Offering"

One commenter reiterated its concern, also expressed in response to FINRA's proposed shelf amendments, that FINRA Rule 5110 and NASD Rules 2720 and 2810 should not be extended to any sale of securities (even one share) from a registration statement or offering circular, including a takedown of securities from a shelf registration statement that does not meet the standard of being a "distribution" for purposes of SEC Regulation M.[76] The appropriate filing requirements for shelf takedowns are addressed in FINRA's response to comments on the proposed shelf amendments.

Comments on the Proposed Definition of "QIU"

One commenter suggested that the disciplinary history lookback period should not be extended from five years to ten.[77] FINRA believes that a longer lookback period is consistent with the goal of ensuring that a QIU will provide the necessary investor protection in public offerings where a member has a conflict of interest. Additionally, FINRA notes that a ten-year lookback is consistent with the period used to determine whether a person is subject to a statutory disqualification.

One commenter suggested that ownership of five percent or more of the issuer's securities is too low a threshold for purposes of disqualification as a QIU and should be

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75 ABA Letter.

76 ABA Letter.

77 ABA Letter.

increased to ten percent in proposed Rule 2720(f)(12)(B).[78] FINRA believes that the five percent threshold is not too low and in fact considered lowering it to three percent.

This commenter also believes that the term "5% of the class of securities that would give rise to a conflict of interest" contained in proposed Rule 2720(f)(12)(B) improperly suggests that the member's conflict of interest is with the issuer's securities rather than with the issuer and should be replaced with "5% of the issuer's total equity securities."[79] FINRA does not agree. Because the proposed Rule addresses conflicts resulting from the receipt of offering proceeds by the member, the five percent standard is appropriately limited to the class of securities offered.

One commenter suggested that the Rule should permit a prospective QIU to demonstrate on a case-by-case basis that it has acquired experience within the previous years involving the pricing and due diligence functions.[80] FINRA believes that such an approach would be unmanageable and that a bright-line test is necessary.

One commenter suggested that FINRA should eliminate the requirement that FINRA members wishing to act as a QIU must qualify on an annual basis.[81] This commenter stated that when a participating member acts as a QIU, that member represents by way of prospectus disclosure that it is qualified to act and the commenter believes that FINRA should not require proof in each case. FINRA notes that there is no annual qualification requirement contained in the current or proposed Rule. Rather, to

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78 SIFMA Letter.

79 SIFMA Letter.

80 SIFMA Letter.

81 SIFMA Letter.

streamline the QIU process, FINRA's Corporate Financing Department permits members to provide information establishing that they meet the QIU qualification requirements in advance of participating in a particular public offering and to update this information annually. In the course of its review of information in connection with a public offering requiring a QIU, FINRA staff routinely asks for information that establishes that a member identified as a QIU is qualified to participate in that capacity. If a member has already provided this information within the last 12 months or has done an annual update, the member will not need to provide the information in connection with that particular offering.

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.[82]

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

Not applicable.

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

Not applicable.

9. Exhibits

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

Exhibit 2. NASD Notice to Members 06-52 (September 2006) and comments

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82 15 U.S.C. 78s(b)(2).

received in response to NASD Notice to Members 06-52 (September 2006). A copy of the Notice is attached as Exhibit 2a. A list of the comment letters received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. (See original filing dated September 6, 2007.)

Exhibit 4. Exhibit 4 shows changes to the text of the proposed rule change pursuant to this Amendment No. 1, marked to show additions to and deletions from the text as proposed in the original filing.

Exhibit 5. Text of proposed rule change marked to show additions to and deletions from the current rule language.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2007-009)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change to Modernize and Simplify NASD Rule 2720

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 September 6, 2007, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") and amended on ----------,[3] 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 modernize and simplify NASD Rule 2720 (Distributions of Securities of Members and Affiliates – Conflicts of Interest), which governs public offerings of securities in which a member with a conflict of interest participates and make corresponding changes to FINRA Rule 5110 (Corporate Financing Rule).

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

2 17 CFR 240.19b-4.

3 This Amendment No. 1 to SR-FINRA-2007-009 replaces and supersedes the original filing submitted on September 6, 2007, except with regard to Exhibit 2 (NASD Notice to Members 06-52 and comments received in response to NASD Notice to Members 06-52).

The text of the proposed rule change is available on FINRA's Web site at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

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

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

FINRA is filing this Amendment No. 1 to SR-FINRA-2007-009 to make certain changes to the original filing of September 6, 2007 to address the Commission staff's comments.

NASD Rule 2720 governs public offerings of securities issued by participating members or their affiliates, public offerings in which a member or any of its associated persons or affiliates has a conflict of interest and public offerings that result in a member becoming a public company. The Rule regulates the potential conflicts of interest that exist with respect to the pricing of such offerings and the conduct of due diligence when a member participates in such offerings.

In September 2006, FINRA published NASD Notice to Members 06-52 requesting comment on proposed amendments to NASD Rule 2720 (the "original

proposal"). FINRA received two comment letters that generally supported the proposal and recognized the need to modernize the Rule.[4] However, in response to the comments received, FINRA staff made certain revisions to the proposal.

The proposed rule change would replace the current Rule in its entirety with proposed NASD Rule 2720 entitled "Public Offerings of Securities With Conflicts of Interest." Some of the more significant amendments that FINRA is proposing in this proposed rule change are to: (1) exempt from the filing and qualified independent underwriter ("QIU") requirements public offerings of investment grade rated securities, public offerings of securities that have a bona fide public market, and public offerings in which the member primarily responsible for managing the offering does not have a conflict of interest and can meet the disciplinary history requirements for a QIU; (2) amend the definition of "conflict of interest" to include public offerings in which at least five percent of the offering proceeds are directed to a participating member or its affiliates; (3) modify the Rule's disclosure requirements to provide more prominent disclosure of conflicts of interest in the offering documents; and (4) amend the Rule's provisions regarding the use of a QIU to focus on the QIU's due diligence responsibilities and eliminate the requirement that the QIU render a pricing opinion. In addition, the proposed rule change would amend the QIU qualification requirements to: (1) focus on the experience of the firm rather than its board of directors; (2) prohibit a member from acting as a QIU if it would receive more than five percent of the proceeds of an offering; and (3) lengthen from five to ten years the amount of time that a person involved in due

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4 Letter from the Securities Industry and Financial Markets Association, dated November 1, 2006 (the "SIFMA Letter"); and Letter from the American Bar Association, dated December 4, 2006 (the "ABA Letter").

diligence in a supervisory capacity must have a clean disciplinary history. These and the other proposed amendments are discussed in greater detail below.

Proposed NASD Rule 2720

Proposed Rule 2720(a) provides that no member that has a conflict of interest may participate in a public offering unless the offering meets one of the exemptions set forth in paragraph (a)(1) or a QIU participates in the offering pursuant to paragraph (a)(2).

1. Offerings Exempt from the QIU and Filing Requirements under Paragraph (a)(1)

First, FINRA is proposing an exemption from the QIU and filing requirements for public offerings in which the member primarily responsible for managing the offering (e.g., the book-running lead manager or lead placement agent) does not have a conflict of interest, is not an affiliate of a member that has a conflict of interest, and can meet the disciplinary history requirements for a QIU under proposed paragraph (f)(12)(E). See proposed Rule 2720(a)(1)(A). FINRA staff believes that a QIU should not be required for such offerings because the book-running lead manager or lead placement agent (or member acting in a similar capacity), which does not have conflict of interest, would be expected to perform the necessary due diligence that would otherwise be required of a QIU.[5]

In response to comments on the original proposal,[6] FINRA has amended this

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5 All syndicate members have due diligence responsibility, but the book-runner(s) in a firm commitment offering and the lead placement agent(s) in a best efforts offering typically hire outside counsel to help members meet their due diligence obligations.

6 SIFMA Letter.

provision to clarify that it applies to public offerings in which there are joint books or that are best efforts offerings. However, where there are two or more co-lead managers or co-lead placement agents that have equal responsibilities with regard to due diligence, each must be free of conflicts of interest. Due to the important role a book-runner or dealer-manager can be expected to play in the due diligence process in an offering, even if that responsibility is shared equally with other members, the Rule's QIU provisions would apply, and the offering would have to be filed for review if any book-runner or dealer-manager has a conflict.

Second, FINRA is proposing an exemption from the QIU and filing requirements for public offerings of securities that have a bona fide public market. See proposed Rule 2720(a)(1)(B). The current Rule exempts public offerings of securities for which there is a "bona fide independent market"[7] from Rule 2720's QIU requirement, but not the filing requirement. The proposed rule change would replace the term "bona fide independent market" with "bona fide public market," which is defined in proposed Rule 2720(f)(3) in accordance with the numerical standards set forth in SEC's Regulation M under the Act.[8] Specifically, "bona fide public market" is defined as a market for a security issued by a company that has been reporting under the Exchange Act for at least 90 days, is current in its reporting requirements and whose securities are listed on a national securities exchange with an average daily trading volume of at least $1 million, provided that the issuer's common equity securities have a public float value of at least $150 million. One

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7 "Bona fide independent market" is defined in current Rule 2720(b)(3) as a market in a security that is listed on a national securities exchange or Nasdaq with a market price of $5 per share, aggregate trading volume of 500,000 shares over 90 days and a public float of 5 million shares.

8 17 CFR 242.100 to 105.

commenter expressed strong support for the proposed definition of "bona fide public market."[9]

Third, FINRA is proposing to exempt from the filing requirement, and to retain the existing exemption from the QIU requirement for, public offerings of investment grade rated securities and securities in the same series that have equal rights and obligations as investment grade rated securities.[10] See proposed Rule 2720(a)(1)(C). In response to comments on the original proposal,[11] FINRA has proposed to define "investment grade rated" in proposed Rule 2720(f)(8) to refer to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories. This definition is consistent with the definition proposed by FINRA in SR-NASD-2004-022 relating to the filing requirements and the regulation of public offerings of securities registered with the Commission and offered by members pursuant to SEC Rule 415 (the "proposed shelf amendments").[12]

The three types of public offerings enumerated in paragraphs (a)(1)(A) through (a)(1)(C) of proposed Rule 2720 are not subject to the QIU requirements of the Rule and, by operation of proposed Rule 2720(d), they are not subject to the filing requirements of

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9 ABA Letter.

10 Thus, proposed Rule 2720(a)(1)(C) would apply to public offerings of securities that have not received an individual rating, but are of the same class or series and are considered "pari passu" with other investment grade rated securities issued by the same company.

11 ABA Letter.

12 See Securities Exchange Act Release No. 50749 (November 29, 2004), 69 FR 70735 (December 7, 2004) (notice of filing of SR-NASD-2004-022) and Amendment No. 5 (filed on August 31, 2007), available at http://www.finra.org/Industry/Regulation/RuleFilings/2004/P036671.

FINRA Rule 5110 (formerly NASD Rule 2710).[13] They are, however, subject to the other provisions of proposed Rule 2720, e.g., the escrow and discretionary account requirements in paragraphs (b) and (c) respectively, if applicable. Additionally, these public offerings are subject to certain disclosure requirements. Proposed Rule 2720(a)(1) requires prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering.

In response to the original proposal, one commenter requested clarification regarding the "prominent disclosure" requirement in the proposed Rule.[14] Proposed Rule 2720(f)(10) provides a description of how a member may make "prominent disclosure" for purposes of paragraphs (a)(1) and (a)(2)(B). Specifically, a member may make 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 provide such disclosures in the Plan of Distribution section required in Item 508 and any Prospectus Summary section required in Item 503 of SEC Regulation S-K. For offering documents not subject to SEC Regulation S-K, "prominent disclosure" may be made 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. These methods of disclosure are a non-exclusive

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13 On September 11, 2008, the SEC approved proposed rule change SR-FINRA-2008-039, in which FINRA proposed, among other things, to adopt NASD Rule 2710 as FINRA Rule 5110 in the Consolidated FINRA Rulebook. See Securities Exchange Act Release No. 58514 (September 11, 2008), 73 FR 54190 (September 18, 2008) (order approving SR-FINRA-2008-039). SR-FINRA-2008-039 was implemented on December 15, 2008. See Regulatory Notice 08-57 (October 2008).

14 ABA Letter.

safe harbor for effecting "prominent disclosure," and FINRA will consider alternative – but equally prominent – disclosures on a case-by-case basis.

2. Offerings in Which a QIU Must Participate under Paragraph (a)(2)

If a member with a conflict of interest participates in a public offering that does not meet the conditions of proposed Rule 2720(a)(1), then pursuant to proposed Rule 2720(a)(2)(A), a QIU must participate in the preparation of the registration statement and the prospectus, offering circular or similar document and exercise the usual standards of "due diligence" with respect thereto.[15]

Like proposed Rule 2720(a)(1), proposed Rule 2720(a)(2)(B) requires "prominent disclosure," as defined in proposed Rule 2720(f)(10), in the prospectus, offering circular or similar document of the nature of the conflict of interest. In addition, proposed Rule 2720(a)(2)(B) requires disclosure of the name of the member acting as QIU and a brief statement regarding the role and responsibilities of the QIU. The disclosure requirements contained in current Rule 2720(d) require that, among other things, the offering documents expressly state that the member acting as QIU (if one is required for the offering) is assuming its responsibilities in pricing the offering and conducting due diligence. In response to commenters' concerns that such a statement potentially could give rise to liability on the part of the QIU,[16] FINRA is proposing to replace this disclosure requirement with a more general statement about the role and responsibilities of a QIU.

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15 The requisite qualifications of a QIU are set forth in the definition of "qualified independent underwriter" in proposed Rule 2720(f)(12), which is discussed in greater detail below.

16 ABA Letter; SIFMA Letter.

A public offering in which a QIU participates pursuant to proposed paragraph (a)(2) is subject to the filing requirements of Rule 5110. See proposed Rule 2720(d). Additionally, a public offering in which a QIU participates must meet Rule 2720's escrow and discretionary account requirements, if applicable.

Current Rule 2720 requires that a QIU provide an opinion that the price at which equity securities are offered to the public is no higher, or the yield for debt securities is no lower, than that recommended by the QIU. The proposed rule change would eliminate the requirement that a QIU provide a pricing opinion. FINRA staff is unaware of instances where QIUs have made recommendations that were inconsistent with pricing decisions by the book-running lead manager or lead placement agent. In addition, FINRA staff believes that QIU pricing opinions in at-the-market offerings are of little to no value. Both commenters expressed strong support for eliminating the QIU pricing requirement.[17]

3. Escrow of Proceeds; Net Capital Computation

Proposed Rule 2720(b)(1) requires that all proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with the net capital requirements set forth in paragraph (b)(2). This proposed provision mirrors current Rule 2720(e).[18]

The net capital requirements set forth in proposed Rule 2720(b)(2) mirror current Rule 2720(e)(2), except that FINRA is proposing to replace the reference to SEC Rule

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17 ABA Letter; SIFMA Letter.

18 Members are reminded that additional escrow account maintenance and payment requirements may be applicable under SEC Rule 15c2-4.

15c3-1(f) with a reference in proposed Rule 2720(b)(2) to the alternative standard for calculating net capital under SEC Rule 15c3-1(a)(1)(ii).

In addition, proposed Rule 2720(b)(3) provides that 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). This provision mirrors current Rule 2720(d)(1).

4. Disclosure

Current Rule 2720(d)(1) requires disclosure in the registration statement or offering circular regarding the date the offering will be completed and the terms upon which proceeds will be released from the escrow account. Current Rule 2720(d)(2) requires disclosure: (1) that the offering is being made pursuant to Rule 2720; (2) relating to the member's status in the offering; and (3) relating to the QIU (if one is required).

The proposed rule change would delete current paragraph (d) of Rule 2720 and, as discussed above, move the disclosure requirements in current paragraph (d)(1) to proposed paragraph (b)(3), and establish separate disclosure requirements for public offerings in which a QIU participates (see proposed Rule 2720(a)(2)(B)) and public offerings in which a QIU does not participate (see proposed Rule 2720(a)(1)).

5. Discretionary Accounts

Proposed Rule 2720(c) provides that, notwithstanding 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. This provision differs from current Rule 2720 in that FINRA has narrowed the proposed Rule to apply only to the sale of securities by the member with the conflict of interest, rather than limit discretionary sales by all firms participating in the offering, even those that do not have a conflict of interest. One commenter expressed support for limiting this provision to the member that has a conflict.[19] Additionally, FINRA notes that the "specific written approval" requirement in this provision can be satisfied by an email from the customer.

6. Application of Rule 5110

As noted above, proposed Rule 2720(d) provides that any public offering subject to the QIU requirements of paragraph (a)(2) is subject to Rule 5110, whether or not the offering would otherwise be exempted from that Rule's filing or other requirements. Rule 5110 generally requires members to file with FINRA public offerings for review of the proposed underwriting terms and arrangements. Rule 5110 contains certain exemptions from the filing requirements for, among others, public offerings of the securities of seasoned issuers[20] and offerings of investment grade debt. However, pursuant to current Rule 2720(m), these exemptions are inapplicable to public offerings that fall within the scope of Rule 2720. Thus, for example, while a public offering of the

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19 ABA Letter.

20 The "seasoned issuer" filing exemption in Rule 5110(b)(7)(C) currently exempts offerings registered on Forms S-3 and F-3 by issuers that meet the standards for those Forms prior to October 21, 1992 (i.e., a three-year reporting history and either $150 million float or $100 million float and annual trading volume of three million shares). The proposed shelf amendments (see supra note 12) would preserve the current filing requirements and amend the Rule to specifically describe the pre-October 21, 1992 standards.

securities of a seasoned issuer is normally exempt from filing under Rule 5110, if a member participating in the offering has a conflict of interest with the seasoned issuer, it must be filed and comply with Rule 5110. The proposed rule change narrows this filing requirement to apply only to those public offerings that fall within the scope of proposed Rule 2720(a)(2).

In response to comments on the original proposal,[21] FINRA is proposing to amend current Rule 5110(b)(7), which lists offerings that are exempt from the Rule 5110 filing requirements, to specify that documents and information related to the public offerings listed in Rule 5110(b)(7) are not required to be filed with FINRA for review, unless the public offering is subject to the QIU requirements of Rule 2720(a)(2). This would clarify that if a public offering listed in Rule 5110(b)(7) is subject to Rule 2720(a)(1), such offering would not be subject to the filing requirements of Rule 5110.

7. Requests for Exemption from Rule 2720

Proposed Rule 2720(e) provides that pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule that it deems appropriate. This provision mirrors existing Rule 2720(o).

8. Definition of "Affiliate"

Proposed Rule 2720(f)(1) defines the term "affiliate" as an entity that controls, is controlled by or is under common control with a member. While current Rule 2720(b)(1) incorporates the "control" standard in the definition of affiliate, FINRA is proposing

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21 SIFMA Letter.

instead to adopt a separate definition of "control," which is discussed below.

In response to comments on the original proposal,[22] FINRA has narrowed the proposed definition of "affiliate" to apply only where an entity controls, is controlled by or is under common control with a member. As originally proposed, the definition would have applied where an entity was under common control with another entity that controls, was controlled by or was under common control with a member.

9. Definition of "Beneficial Ownership"

Proposed Rule 2720(f)(2) defines "beneficial ownership" as the right to the economic benefits of a security. This provision mirrors the definition contained in current Rule 2720(b)(2). In NASD Notice to Members 06-52, FINRA requested comment on whether Rule 2720 should incorporate the definition of "beneficial ownership" found in SEC Rule 13d-3. That definition includes the right to dispose and vote the securities, which would apply to many investment funds. In response to comments suggesting that the definition should be confined to economic interests in which the member can profit directly,[23] FINRA is proposing to retain the current definition of "beneficial ownership."

10. Definition of "Common Equity"

Proposed Rule 2720(f)(4) defines "common equity" as 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. This

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22 ABA Letter.

23 ABA Letter.

definition mirrors current Rule 2720(b)(5).

11. Definition of "Conflict of Interest"

Proposed Rule 2720(f)(5) would define "conflict of interest" to mean, if at the time of a member's participation in an entity's public offering, any of four conditions applies. The Rule would operate much as it does today; however, the proposed rule change would relocate many of the current Rule's substantive concepts to the definition of "conflict of interest."

First, pursuant to proposed Rule 2720(f)(5)(A), a conflict of interest would exist if the securities are to be issued by the member.

Second, pursuant to proposed Rule 2720(f)(5)(B), a conflict of interest would exist if the issuer controls, is controlled by or is under common control with the member or the member's associated persons. "Control" is defined in proposed Rule 2720(f)(6) and is discussed below.

Third, pursuant to proposed Rule 2720(f)(5)(C), a conflict of interest would exist where at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be: (i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or (ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate. In response to comments on the original proposal,[24] FINRA has amended the proposed definition to clarify that the proceeds are net of underwriting compensation.

Currently, Rule 5110(h) requires public offerings in which ten percent or more of

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[24] SIFMA Letter.

the offering proceeds (not including the underwriting discount) will be paid to participating members to comply with Rule 2720's QIU requirements. Pursuant to this proposed rule change, FINRA is proposing to delete Rule 5110(h) and move the proceeds requirement to Rule 2720 by defining "conflict of interest" to include a member's participation in a public offering where proceeds are directed to the member. Although the threshold for proceeds directed to a member is being lowered from ten percent to five percent, the new threshold would apply to <u>each</u> participating member individually (including the member's affiliates and its associated persons), not on an aggregate basis for all participating members, as is currently the case. Thus, for example, a conflict of interest would exist where a member received five percent of the proceeds, but not where two unaffiliated members each received three percent of the proceeds.

Fourth, pursuant to proposed Rule 2720(f)(5)(D), a conflict of interest would exist if, as a result of the public offering and any transactions contemplated at the time of the public offering: (i) the member will be an affiliate of the issuer; (ii) the member will become publicly owned; or (iii) the issuer will become a member or form a broker-dealer subsidiary.

In response to comments on the original proposal,[25] FINRA is clarifying that for purposes of Rule 2720, "participation in a public offering" has the same meaning as in Rule 5110. Rule 5110(a)(5) provides that "participation or participating in a public offering" means "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

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25 SIFMA Letter.

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 SEA Rule 13e-3."[26]

12. Definition of "Control"

As noted above, under the current Rule, the control standard is incorporated in the definition of "affiliate." The proposed rule change would instead adopt the following definition of "control:" (i) beneficial ownership[27] of ten percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member's participation in the public offering; (ii) the right to ten percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering; (iii) beneficial ownership of ten percent or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member's participation in the public offering; (iv) beneficial ownership of ten percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or (v) the power to direct or cause the direction of the management or policies of an entity. See proposed Rule 2720(f)(6)(A).

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[26] Pursuant to the proposed shelf amendments (see supra note 12), Rule 5110(a)(5) would be amended to specify participation in the distribution of the offering on an "underwritten, non-underwritten, principal, agency or any other basis" and to include "participation in a shelf takedown" in this definition.

[27] The term "beneficial ownership" is defined in proposed paragraph (f)(2). In response to a comment by Commission staff, FINRA is clarifying that the use of that term in proposed paragraph (f)(6) is a more narrow interpretation of the term owing to the numerical thresholds imposed by this subparagraph.

FINRA believes it is important in subparagraph (i) to include entities other than corporations, to expressly include conflicts that may arise in connection with the offerings of, for example, trusts.

In its original proposal and the original filing of September 6, 2007, FINRA proposed that the definition of control would eliminate ownership of subordinated debt and preferred equity as a basis for a conflict of interest.[28] However, in response to comments from Commission staff, FINRA is proposing in this Amendment No. 1 to include beneficial ownership of ten percent or more of the outstanding common equity (which is defined expressly to include non-voting stock), subordinated debt or preferred equity in the proposed definition of control. Thus, for example, "control" could derive from the restrictive covenants typically found in debt indentures, preferred rights to dividends given to holders of non-voting common or preferred stock or special voting rights given to certain classes of (generally) non-voting stock. FINRA is specifically requesting comment on whether such forms of ownership give rise to a conflict of interest and should be included in the proposed Rule.

The proposed definition of control includes not only shares beneficially owned by a participating member, but also the right to receive such securities within 60 days of the member's participation in the public offering. In its original filing of September 6, 2007, FINRA proposed that for purposes of this provision, 60 days would be from the effective date of the offering. However, in this Amendment No. 1, FINRA is revising the proposed rule text to provide that the relevant time frame is "within 60 days of the

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[28] See current Rule 2720(b)(7)(A) and (C).

member's participation in the public offering."[29] This will ensure that the Rule properly applies to takedowns from an effective shelf registration. FINRA believes that the determination of control should be when the member participates in an offering, not the date that a registration statement for the offering is declared effective.

Thus, under the proposed rule change, warrants or rights for voting securities that are exercisable within 60 days of the member's participation in the public offering would be included in the calculation of voting securities when determining whether control exists. In response to comments on the original proposal, FINRA is clarifying that in calculating the percentage beneficial ownership, it is appropriate to include the potential ownership of shares in both the numerator and denominator.[30] FINRA does not believe, however, that this calculation should include securities that could be received by all investors. Rather, the calculation is limited to warrants or rights that are exercisable within 60 days and received by the participating member only and would not include warrants or rights held by other investors.

13. Definition of "Entity"

Currently, Rule 2720 does not contain a definition of "entity." Pursuant to proposed Rule 2720(f)(7), an "entity" would be defined, for purposes of the definitions of affiliate, conflict of interest and control under the Rule, as "a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons."

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29 See supra page 59 for a discussion of the definition of the term "participation in a public offering."

30 See ABA Letter (requesting that FINRA clarify whether the amount of securities to be received by a member and any other person within 60 days of the offering will be included in the denominator in order to calculate the member's total ownership interest in the issuer's securities).

The proposed definition would expressly exclude: (i) an investment company registered under the Investment Company Act of 1940; (ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act of 1940; (iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code; and (iv) a "direct participation program" as defined in NASD Rule 2810. These exclusions are substantially similar to the exemptions from the "conflict of interest" provisions contained in current Rule 2720(b)(7)(D). In response to comments on the original proposal,[31] FINRA revised the proposed definition of "conflict of interest" to apply only to a public offering of an "entity."

14. Definition of "Preferred Equity"

Proposed Rule 2720(f)(9) defines the term "preferred equity" as the aggregate capital invested by all persons in the preferred securities 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. This definition mirrors current Rule 2720(b)(12).

15. Definition of "Public Offering"

Proposed Rule 2720(f)(11) essentially mirrors the definition of "public offering" in current Rule 2720(b)(14) and would define the term as any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition and all other securities offerings of any kind whatsoever. The proposed definition excludes from its scope any offering made pursuant to: (i) an exemption from

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31 SIFMA Letter.

registration under Sections 4(1), 4(2) or 4(6) of the Securities Act of 1933;[32] and (ii) SEC Rule 504, if the securities are "restricted securities" under SEC Rule 144(a)(3), SEC Rules 505 or 506. FINRA currently does not interpret an offering made pursuant to SEC Regulation S to be within the scope of a "public offering" under this Rule and as such, is proposing also to exclude these offerings from the definition. Additionally, in response to comments on the original proposal,[33] FINRA has amended the proposed definition of "public offering" to expressly exclude exempted securities as defined in Section 3(a)(12) of the Exchange Act,[34] as in the current Rule.

One commenter suggested that the proposed Rule should provide an express exclusion for offerings made pursuant to SEC Rule 144A.[35] FINRA agrees and has added an express exclusion for offerings under SEC Rule 144A.[36] FINRA also notes that it currently does not interpret an offering made pursuant to SEC Rule 144A to be within the scope of either Rule 5110 or Rule 2720.

16. Definition of "Qualified Independent Underwriter"

Proposed Rule 2720(f)(12) defines the term "qualified independent underwriter" as a member that meets the following conditions. First, the member must not have a conflict of interest and must not be an affiliate of any member that has a conflict of interest. See proposed Rule 2720(f)(12)(A). The Rule currently does not disqualify or

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32 15 U.S.C. 77d(1), (2) or (6).

33 ABA Letter.

34 15 U.S.C. 78c(a)(12).

35 ABA Letter.

36 See Securities Act Release No. 6862, 55 FR 17933 (April 30, 1990) (File No. S7-23-88).

prohibit a QIU from receiving proceeds from an offering. The proposed rule change would prohibit a QIU from receiving more than five percent of the offering proceeds because the receipt of such proceeds would disqualify a member from acting as a QIU because it would fall within the proposed definition of "conflict of interest."

Second, the member cannot beneficially own, as of the date of the member's participation in the public offering, more than five percent 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. See proposed Rule 2720(f)(12)(B). Current Rule 2720(b)(15)(E) prohibits a member from acting as a QIU if it is an affiliate of the issuer or if it beneficially owns at least five percent of the equity, subordinated debt or partnership interest of the issuer. The proposed rule change would maintain these prohibitions.

Third, the member must have agreed, in acting as a QIU, to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in Section 11 thereof.[37] See proposed Rule 2720(f)(12)(C). The proposed provision mirrors current Rule 2720(b)(15)(F).

Fourth, the member must have 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 for which there is no 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

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[37] 15 U.S.C. 77k.

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. See proposed Rule 2720(f)(12)(D). FINRA is specifically requesting comment on whether the 50% threshold should be lowered if an equity offering is particularly large (e.g., over $1 billion). The proposed requirements mirror those set forth in current Rule 2720(b)(15)(C), except that currently, the relevant period is five years. In addition to shortening this period to three years, the proposed rule change also would impose, as discussed above, the requirement that a QIU must have acted as a managing underwriter in at least three similar offerings during that time.

Additionally, Rule 2720(b)(15)(B) currently permits a member to serve as a QIU only if the member: (i) is a sole proprietorship and the sole proprietor has been actively engaged in the investment banking or securities business for the five-year period immediately preceding the filing of the registration statement, or (ii) is a corporation or partnership and a majority of its board of directors or general partners has been similarly engaged in the investment banking or securities business. The proposed rule change would eliminate the requirement regarding board or partner experience, since FINRA staff believes that the experience of the firm is more relevant.

Finally, none of the member's associated persons in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to

corporate public offerings of securities shall: (i) have 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) be 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) have been suspended or barred from association with any member by an order or decision of the Commission, 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. See proposed Rule 2720(f)(12)(E). The Rule currently prohibits an associated person's involvement in the due diligence process in a supervisory capacity if that person has been subject to certain criminal and disciplinary actions pertaining to the offering of securities within five years prior to the filing of the registration statement. The proposed rule change, as described above, would lengthen this period from five to

ten years.

17. Definition of "Registration Statement"

Proposed Rule 2720(f)(13) defines the term "registration statement" as a registration statement as defined by Section 2(a)(8) of the Securities Act of 1933;[38] notification on Form 1A filed with the Commission pursuant to the provisions of SEC Rule 252 under the Securities Act of 1933; 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. This definition mirrors current Rule 2720(b)(16), except for technical changes to correct the references in the current Rule to Section 2(8) of the Securities Act and SEC Rule 255.

18. Definition of "Subordinated Debt"

Proposed Rule 2720(f)(14) defines "subordinated debt" to include (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. This definition mirrors current Rule 2720(b)(18).

19. Deleted Definitions

Proposed Rule 2720 does not contain the following definitions that appear in current Rule 2720: company, effective date, immediate family, parent, person, public

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[38] 15 U.S.C. 77b(a)(8).

director and settlement. In response to comments on the original proposal,[39] FINRA is proposing to adopt the current definitions of company, effective date, immediate family and person as new paragraphs (a)(11) through (14) of Rule 5110 because they are used in that Rule.[40] Proposed Rule 2720(f) provides that the definitions in Rule 5110 are incorporated by reference in Rule 2720.

17. Corporate Governance and Periodic Reporting

Rule 2720 currently includes certain provisions that do not apply to the public offering itself and instead require the issuer to adopt corporate governance policies relating to an audit committee and public directors and to issue periodic reports to shareholders.[41] With the enactment of the Sarbanes-Oxley Act and recent SEC rulemaking and interpretive actions, issuers' periodic reporting requirements under the Exchange Act have been enhanced and listing standard changes intended to improve corporate governance and enhance the role of audit committees have been adopted. Accordingly, at this time, FINRA believes that separate Rule 2720 requirements for corporate governance and periodic reporting are unnecessary. One commenter expressed support for eliminating these provisions from Rule 2720.[42]

18. Intrastate Offerings

Rule 2720(j) currently requires any member offering its securities pursuant to the

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39 ABA Letter.

40 Pursuant to the proposed shelf amendments, FINRA proposed to adopt certain new definitions as paragraphs (a)(11) through (14) of Rule 5110. See supra note 12. This proposed rule change is not intended to supersede those proposed amendments.

41 See paragraphs (f), (g) and (h) of current Rule 2720.

42 ABA Letter.

intrastate offering exemption under the Securities Act to include in the offering documents information required in a release that the SEC published in 1972. The proposed amendments would delete this requirement from Rule 2720. FINRA believes that disclosure requirements for unregistered offerings should be addressed in a more comprehensive manner by the SEC, the states or FINRA, and not imposed under the narrow scope of Rule 2720 or limited to intrastate offerings. One commenter suggested that FINRA should not adopt disclosure requirements for intrastate offerings because such offerings are subject to the disclosure requirements of the state where the securities are offered.[43]

19. Suitability

Rule 2720(k) currently requires that every member underwriting an issue of its own securities, or securities of an affiliate or company with which it has a conflict of interest that recommends to a customer the purchase of a security of such issue must have reasonable grounds to believe that the recommendation is suitable for the customer. FINRA is not proposing a similar provision in new Rule 2720 because NASD Rule 2310 already addresses a member's obligations relating to suitability.

FINRA will announce the implementation date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The implementation date will be 30 days following publication of the Regulatory Notice announcing Commission approval.

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[43] ABA Letter.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[44] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change will simplify and modernize Rule 2720, thereby providing greater clarity regarding members' obligations and enhancing the regulation of public offerings in which members have a conflict of interest.

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

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

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

The proposed rule change was published for comment in NASD Notice to Members 06-52 (September 2006). Two comments were received in response to the Notice. A copy of the Notice is attached as Exhibit 2a. A list of the comment letters received in response to the Notice is attached as Exhibit 2b. Copies of the comment letters received in response to the Notice are attached as Exhibit 2c. Those comments that have not already been addressed herein are discussed below.[45]

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44 15 U.S.C. 78o–3(b)(6).

45 In addition, FINRA has incorporated some of the commenters' non-substantive comments without specifically addressing them herein, e.g., comments regarding inconsistent use of the terms "entity," "company" and "issuer." See ABA Letter.

Comments on the Scope of Proposed Rule 2720

Both commenters suggested revising proposed Rule 2720(a)(1) to include additional categories of public offerings that would be exempt from the QIU and filing requirements by operation of proposed Rule 2720(d). As discussed in greater detail below, FINRA does not agree that the exemptions should be expanded further. FINRA notes that, as proposed, the Rule would significantly reduce the number of public offerings that must be filed and reviewed by FINRA staff. A public offering (that is not an offering of investment grade rated securities or securities with a bona fide public market) will be subject to the QIU and filing requirements under Rule 2720 only if a member with primary responsibility for managing the offering has a conflict of interest. As such, FINRA does not believe that it would be appropriate to further expand the automatic exemptions under the Rule, as suggested by the commenters.

Specifically, the commenters suggested that paragraph (a)(1) of the proposed Rule should include "well-known seasoned issuers" or "WKSIs."[46] The commenters contend that such a change would be consistent with the proposed shelf amendments, which would exempt all WKSI shelf offerings from the filing requirements of Rule 5110.[47] FINRA does not agree. FINRA believes that if a participating member has a conflict of interest, the offering should be subject to the QIU and filing requirements, irrespective of

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46 ABA Letter; SIFMA Letter.

Pursuant to amendments to SEC rules governing shelf offerings, which became effective on December 1, 2005, WKSIs are defined as S-3 eligible issuers that have either $700 million of worldwide equity market capitalization or an aggregate $1 billion of non-convertible securities issued within the past three years. See Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722 (August 3, 2005) (SEC File No. S7-38-04).

47 ABA Letter; SIFMA Letter.

whether the issuer involved is a WKSI. Today, a WKSI that is not required to file under Rule 5110 would nonetheless be required to obtain a QIU if it were to receive ten percent of the offering proceeds. See current Rules 5110(h) and 2720(m). In addition, FINRA does not agree that application of Rule 2720 to WKSIs would slow the offering process.[48] Currently, all WKSI filings are reviewed and cleared on the same day they are received by FINRA's Corporate Financing Department. In connection with the proposed shelf amendments, FINRA is developing upgrades to the COBRADesk electronic filing system that will implement a new same-day automatic review and clearance process for most shelf offerings and all WKSI shelf offerings.[49]

Similarly, one commenter suggested that public offerings by issuers with investment grade rated debt, which are currently exempted by Rule 5110(b)(7)(A), should be included in proposed Rule 2720(a)(1).[50] FINRA does not agree. The proposed rule change is designed to focus on the particular public offering in which a member has a conflict of interest. FINRA believes that while it is appropriate to exempt certain public offerings from the Rule, it would be inappropriate to exempt an entire class of issuers such as WKSIs or all issuers with investment grade rated debt. The relevant inquiry is whether the member has a conflict of interest with respect to that offering of that security; the characteristics of the issuer should not be determinative. As such, FINRA also does not agree with the commenter that proposed paragraphs (a)(1)(B) and (C) should be

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48 SIFMA Letter.

49 See supra note 12.

50 SIFMA Letter.

amended to refer to the issuer of the securities, instead of the securities being offered.[51]

One commenter suggested that the exception under proposed Rule 2720(a)(1)(B) should be available for public offerings of warrants, options, convertible debt and convertible preferred securities that are exercisable for or convertible into equity securities that meet the standard of having a bona fide public market.[52] FINRA does not believe that such an exemption would be appropriate because the characteristics of the derivative will not always be the same as the underlying security. The existence of a bona fide public market in the underlying equity security does not necessarily extend to an offering of a derivative on that security.

One commenter also suggested that there should be an exception for offerings by banks and other financial institutions that are the parents or affiliates of FINRA members of medium-term notes or similar securities, the return of which is linked to the performance of a particular stock, asset or index.[53] While an offering of these securities that are rated investment grade would be exempted under the proposed Rule, FINRA believes that an offering of such securities rated below investment grade should continue to be subject to the filing and QIU requirements. FINRA believes that an exemption for offerings of structured products rated below investment grade would be inconsistent with concerns expressed by FINRA about these securities.[54] However, to avoid potential

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51 SIFMA Letter.

52 ABA Letter.

53 ABA Letter.

54 See NASD Notice to Members 05-59 (September 2005). The Notice stated that FINRA is concerned that when members sell structured products, they may not be fulfilling their sales practice obligations, including the requirement to perform a reasonable-basis and customer-specific suitability determination. The Notice also

unintended consequences of the proposed Rule, FINRA is specifically requesting comment on whether certain other types of securities that are registered on a shelf registration statement or automatic shelf registration statement should be eligible for the exemption from the filing and QIU requirements.

Both commenters suggested that the reorganizations, mergers and acquisition transactions that are currently exempted by Rule 2720(a)(3) should be exempted under proposed Rule 2720(a)(1).[55] FINRA believes that unless a reorganization, merger or acquisition would otherwise meet the proposed Rule 2720(a)(1) exemptions, it should be subject to the QIU and filing requirements. The Rule currently applies to these transactions if the member or its parent issues shares or the transaction results in the public ownership of a member. Thus, there is not currently a blanket exemption for reorganizations, mergers and acquisitions.

One commenter also suggested that the proposed Rule should exempt all offerings by government entities.[56] FINRA has proposed to exclude certain government entities from the filing requirements of Rule 5110 pursuant to the proposed shelf amendments;[57] however, FINRA does not agree that all such offerings should be excluded under Rule 2720. If a member has a conflict of interest with a government entity (e.g., the member

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raised specific concerns about member sales practice obligations when selling these instruments to retail customers. The Notice added that structured products have been increasingly targeted at retail investors and that FINRA is concerned about the manner in which such products are marketed and the types of investors purchasing such products.

55 ABA Letter; SIFMA Letter.

56 SIFMA Letter.

57 See supra note 12.

will receive at least five percent of the net proceeds of the public offering) and the public offering does not otherwise meet the Rule 2720(a)(1) exemptions, FINRA believes that the offering documents should be filed and reviewed by FINRA staff.

One commenter suggested that offerings of securities exempt from registration with the Commission under Section 3(a)(4) of the Securities Act of 1933 should be exempt under proposed Rule 2720(a)(1), noting that such offerings currently are exempted from the conflict of interest provisions of Rule 2720.[58] While FINRA is not aware of member conflicts with non-profit or charitable organizations, in the unlikely event that such a conflict does exist, FINRA believes that the offering should be filed and reviewed by FINRA staff.

This same commenter also suggested that proposed Rule 2720(a)(1) should exclude offerings conducted pursuant to the multi-jurisdictional disclosure system because they are already subject to regulation under the Canadian system.[59] FINRA does not agree that it should remove itself from public offerings in which a FINRA member with a conflict of interest is participating, even if such offerings also are subject to regulation under the Canadian system.

Finally, with respect to proposed Rule 2720(a)(1)(A), one commenter suggested amending the provision to apply to any book-running manager, including co- or joint book-running managers, such that a QIU would not be required if any of the joint book-runners could meet the requirements of the Rule.[60] FINRA does not agree that the

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58 SIFMA Letter.

59 SIFMA Letter.

60 SIFMA Letter.

provision should be expanded in this way. FINRA understands that in some joint book offerings, members have been designated as a joint book-runner or co-lead manager in return for assistance with the road show or other services critical to marketing the offering. In some cases, the member designated as a co-lead would not be in the position of supervising due diligence for the offering or may not be involved in the due diligence at all. FINRA staff does not believe that including a book-runner or lead placement agent without a conflict of interest eliminates the conflict that exists with respect to the remaining book-runner(s) or lead placement agent(s). Therefore, amending the proposed provision as the commenter suggests would not fulfill the objective of ensuring independent due diligence by a member free of conflicts.

Comments on Proposed QIU Requirements

One commenter suggested that the references to "due diligence" and "usual standards of due diligence" should be eliminated from the Rule, expressing concern that such references could raise the due diligence defense to the level of a regulatory requirement.[61] The requirement that a QIU exercise the usual standards of due diligence has been in the Rule for 20 years (see, e.g., current Rule 2720(c)(3)(A) and (d)(2)) and FINRA believes that it is an appropriate regulatory requirement. However, as discussed above, in response to comments, as well as similar concerns expressed by FINRA's Corporate Financing Committee, FINRA has eliminated the proposal to require that the offering documents include a statement that the QIU has assumed responsibilities for conducting due diligence.

The commenters also suggested that offerings in which a QIU participates should

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61 SIFMA Letter.

be exempt from the filing requirements of Rule 5110.[62] FINRA does not believe that the participation of a QIU in an offering sufficiently mitigates the conflicts of interest such that FINRA review is no longer necessary. Additionally, pursuant to current Rule 2720(m), the Rule 5110 filing requirements apply to all public offerings subject to Rule 2720, including public offerings in which a QIU has participated. Thus, the proposed rule change would not expand the current filing requirements.

Comments on the Proposed Discretionary Accounts Provision

One commenter[63] suggested that the Rule should be revised to incorporate the advance authorization procedure in FINRA's Corporate Financing Department's exemption letter to Goldman Sachs (the "Goldman Letter").[64] The Goldman Letter applies to public offerings of straight debt securities, structured notes and straight preferred stock issued by Goldman or its affiliates and permits the firm to use an advance authorization procedure in lieu of the requirement in Rule 2720 for prior specific written approval. Specifically, the firm could obtain an advance written letter of consent from certain customers with discretionary accounts and oral authorization by the customer prior to execution of the transaction. FINRA does not believe that Rule 2720 should expressly incorporate the advance authorization procedure set forth in the Goldman Letter. As discussed above, the written authorization requirements of this provision can be satisfied by email, which today may often prove quicker and easier than obtaining oral

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62 ABA Letter; SIFMA Letter.

63 ABA Letter.

64 See letter to Judith G. Belash, Esq., Goldman, Sachs & Co., from Joseph Price, NASD, Corporate Financing Department, dated June 14, 1999, available at http://www.finra.org/Industry/Regulation/Guidance/ExemptiveLetters/P002617.

authorization.

Additionally, this commenter suggested that public offerings in which proceeds are being directed to a member should be exempted from the discretionary account provision.[65] FINRA does not agree. FINRA believes that the receipt of offering proceeds by members and their affiliates gives rise to conflicts that are of equal concern in the context of sales to a discretionary account.

Comments on the Proposed Definition of "Affiliate"

One commenter suggested that the definition of "affiliate" should be structured similar to the current definition as a control standard and a presumption of control as a result of management or share ownership.[66] FINRA recognizes that there are other ways to define "affiliate"; however, this commenter has not demonstrated that its recommended approach is better than the approach FINRA is proposing.

Comments on the Proposed Definition of "Bona Fide Public Market"

The commenters suggested that the definition of "bona fide public market" should be amended to apply to equity securities of foreign issuers that meet the "actively traded" standards of SEC Regulation M and are designated offshore securities markets under Rule 902(b).[67] Upon further consideration, FINRA is not proposing to amend the definition along these lines. Because securities with a bona fide public market are not subject to the QIU or filing requirements, amending the definition to apply to securities traded on a foreign market would make this exemption too broad.

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65 ABA Letter.

66 ABA Letter.

67 ABA Letter; SIFMA Letter.

One commenter also suggested that the definition should be amended to clarify that the issuer – and not the particular security – must have a bona fide public market.[68] FINRA does not agree. As discussed above, the focus of this Rule is on the securities being offered and not the characteristics of the issuer.

Comments on the Proposed Definition of "Conflict of Interest"

The commenters suggested that there should be no filing requirement for public offerings in which the conflict of interest derives from the member's receipt of proceeds.[69] One commenter asserted that "NASD has historically deemed a conflict of interest based on the receipt of offering proceeds by participating members to be a less significant conflict than one that is based on the ownership of an issuer's securities or management control."[70] FINRA does not agree and believes that the conflict deriving from a member's receipt of proceeds warrants review and filing of the offering documents. Indeed, FINRA's Corporate Financing Committee has identified conflicts resulting from proceeds being directed to a member as one of the most important conflicts in public offerings today. Pursuant to the proposed rule change, all public offerings in which a QIU is involved – including those for which a QIU is required because proceeds are being directed to a member or its affiliate – must be filed and reviewed by FINRA staff.

Additionally, both commenters assert that the five percent threshold for a

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68 SIFMA Letter.

69 ABA Letter; SIFMA Letter.

70 ABA Letter.

member's receipt of offering proceeds is too low.[71] FINRA does not agree and believes that in recognition of the significance of proceeds-related conflicts, it is appropriate to lower the threshold from ten percent to five percent.

One commenter suggested that the proposed definition of "conflict of interest" should exclude transactions by which the issuer will become a member or form a broker-dealer subsidiary.[72] This commenter also suggested that the definition be revised to exclude reorganizations and restructurings if no material change in the ownership of the issuer or participating member is taking place.[73] FINRA does not agree that merely because the corporate governance provisions have been deleted from the Rule, a member's participation in such offerings no longer creates a conflict of interest. FINRA believes that these offerings should be subject to the Rule.

This commenter also suggested that the old formulation in which conflicts of interest existed under specific circumstances, rather than as a result of a member's participation in public offerings where certain conditions apply, should be retained because it was easier for members to argue that no conflict actually exists.[74] FINRA does not agree and believes that the proposed definition of "conflicts of interest" is preferable in that it clearly delineates the scope of the Rule.

The commenters suggested that the definition should not apply to arms length forward sales contracts and other derivatives where the proceeds are used by the issuer to

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71 ABA Letter; SIFMA Letter.

72 SIFMA Letter.

73 SIFMA Letter.

74 SIFMA Letter.

purchase the securities to hedge risk in the transactions.[75] FINRA is requesting further comment on this issue and specifically how use of the proceeds by the issuer to buy derivatives or other hedging transactions is substantially different from other uses of proceeds contemplated by the Rule (e.g., to retire debt).

Comments on the Proposed Definition of "Control"

One commenter suggested that "control" should not be a defined term because an entity that is in a control relationship is an affiliate and thus, the control concept should remain in the definition of "affiliate."[76] As previously noted, FINRA recognizes that there are other ways to approach the definitions and standards set forth in this Rule. However, FINRA does not believe that the approach the commenter has proposed is preferable to that outlined above.

Comments on the Proposed Definition of "Entity"

One commenter suggested that the proposed definition of "entity" be amended to include groups of persons only if they are organized to conduct business under the laws of a jurisdiction.[77] FINRA does not agree and believes that more flexibility is needed given that FINRA is not proposing to define "beneficial ownership" in accordance with SEC Rule 13d-3.

Comments on the Proposed Definition of "Public Offering"

One commenter reiterated its concern, also expressed in response to FINRA's proposed shelf amendments, that FINRA Rule 5110 and NASD Rules 2720 and 2810

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75 ABA Letter; SIFMA Letter.

76 ABA Letter.

77 ABA Letter.

should not be extended to any sale of securities (even one share) from a registration statement or offering circular, including a takedown of securities from a shelf registration statement that does not meet the standard of being a "distribution" for purposes of SEC Regulation M.[78] The appropriate filing requirements for shelf takedowns are addressed in FINRA's response to comments on the proposed shelf amendments.

Comments on the Proposed Definition of "QIU"

One commenter suggested that the disciplinary history lookback period should not be extended from five years to ten.[79] FINRA believes that a longer lookback period is consistent with the goal of ensuring that a QIU will provide the necessary investor protection in public offerings where a member has a conflict of interest. Additionally, FINRA notes that a ten-year lookback is consistent with the period used to determine whether a person is subject to a statutory disqualification.

One commenter suggested that ownership of five percent or more of the issuer's securities is too low a threshold for purposes of disqualification as a QIU and should be increased to ten percent in proposed Rule 2720(f)(12)(B).[80] FINRA believes that the five percent threshold is not too low and in fact considered lowering it to three percent.

This commenter also believes that the term "5% of the class of securities that would give rise to a conflict of interest" contained in proposed Rule 2720(f)(12)(B) improperly suggests that the member's conflict of interest is with the issuer's securities rather than with the issuer and should be replaced with "5% of the issuer's total equity

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78 ABA Letter.

79 ABA Letter.

80 SIFMA Letter.

securities."[81] FINRA does not agree. Because the proposed Rule addresses conflicts resulting from the receipt of offering proceeds by the member, the five percent standard is appropriately limited to the class of securities offered.

One commenter suggested that the Rule should permit a prospective QIU to demonstrate on a case-by-case basis that it has acquired experience within the previous years involving the pricing and due diligence functions.[82] FINRA believes that such an approach would be unmanageable and that a bright-line test is necessary.

One commenter suggested that FINRA should eliminate the requirement that FINRA members wishing to act as a QIU must qualify on an annual basis.[83] This commenter stated that when a participating member acts as a QIU, that member represents by way of prospectus disclosure that it is qualified to act and the commenter believes that FINRA should not require proof in each case. FINRA notes that there is no annual qualification requirement contained in the current or proposed Rule. Rather, to streamline the QIU process, FINRA's Corporate Financing Department permits members to provide information establishing that they meet the QIU qualification requirements in advance of participating in a particular public offering and to update this information annually. In the course of its review of information in connection with a public offering requiring a QIU, FINRA staff routinely asks for information that establishes that a member identified as a QIU is qualified to participate in that capacity. If a member has already provided this information within the last 12 months or has done an annual update,

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81 SIFMA Letter.

82 SIFMA Letter.

83 SIFMA Letter.

the member will not need to provide the information in connection with that particular offering.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve 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-2007-009 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2007-009. 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 Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2007-009 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.[84]

Florence E. Harmon

Deputy Secretary

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[84] 17 CFR 200.30-3(a)(12).

EXHIBIT 4

Exhibit 4 shows the text of the proposed rule change, with the changes proposed in the original filing shown as if adopted. Proposed new language in this Amendment No. 1 is underlined; proposed deletions in this Amendment No. 1 are in brackets.[1]

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

[2700] 5100. SECURITIES [DISTRIBUTIONS] OFFERINGS, UNDERWRITING AND COMPENSATION

[2710] 5110. 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 NASD Rule 2720 are incorporated herein by reference.

(1) through (14) No Change.

(b) Filing Requirements

(1) through (6) No Change.

(7) Offerings Exempt from Filing

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[1] The original filing submitted on September 6, 2007 proposed to amend NASD Rule 2710. On September 11, 2008, the SEC approved proposed rule change SR-FINRA-2008-039, in which FINRA proposed, among other things, to adopt NASD Rule 2710 as FINRA Rule 5110 in the Consolidated FINRA Rulebook. See Securities Exchange Act Release No. 58514 (September 11, 2008), 73 FR 54190 (September 18, 2008) (order approving SR-FINRA-2008-039). SR-FINRA-2008-039 was implemented on December 15, 2008. See Regulatory Notice 08-57 (October 2008).

This Exhibit 4 also is marked to show the amendments to NASD Rule 2710 that were adopted pursuant to SR-FINRA-2008-039.

Notwithstanding the provisions of subparagraph (1) above, documents and information related to the following public offerings need not be filed with [NASD] FINRA for review, unless subject to the provisions of NASD Rule 2720(a)(2). However, it shall be deemed a violation of this Rule or NASD Rule 2810, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or NASD Rule 2810, as applicable:

(A) through (G) No Change.

(8) through (9) No Change.

(c) through (i) No Change.

* * * * *

2720. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraphs (1) or (2).

(1) [The] 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, [prominently discloses the nature of the conflict of interest] and one of the following conditions must be met:

(A) the member(s) 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 requirement of paragraph (f)([9]12)(E);

(B) No Change.

(C) the securities offered are [debt or preferred securities that are] investment grade rated or [debt or preferred] are securities in the same series that have equal rights and obligations as investment grade rated securities.

(2) (A) No Change.

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

(i) through (iii) No Change.

(b) Escrow of Proceeds; Net Capital Computation

(1) No Change.

(2) Any member offering its securities pursuant to this Rule shall immediately notify [NASD] FINRA when the public offering has been terminated and settlement effected and shall file with [NASD] FINRA a computation of its net capital computed pursuant to the provisions of SEC Rule 15c3-1 under the Act (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the [provisions of Rule 15c3-1(f) are utilized in making such computation, the] member calculates its net capital requirement using the alternative standard (set forth in Rule 15c3-1(a)(1)(ii)), its net capital is less than seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, all monies received from sales of securities of the public offering must be returned in full to the purchasers

thereof and the offering withdrawn, unless the member has obtained from the Commission a specific exemption from the net capital rule. Proceeds from the sales of securities in the public offering may be taken into consideration in computing net capital ratio for purposes of this paragraph.

(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) No Change.

(d) Application of Rule [2710] 5110

Any public offering subject to paragraph (a)(2) is subject to Rule [2710] 5110, whether or not the offering would be otherwise exempted from the filing or other requirements of that rule.

(e) Requests for Exemption from Rule 2720

Pursuant to the Rule 9600 Series, [NASD] FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this rule that 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 (3) No Change.

(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, [if] any of the following applies:

(A) the securities are to be issued by the member [or its affiliate];

(B) No Change.

(C) at least five percent of the net offering proceeds, not including underwriting compensation, are intended[, as of the effective date of the registration statement or the date of first sale in an offering without a registration statement,] to be:

(i) through (ii) No Change.

(D) No Change.

([5]6) Control

(A) The term "control" means:

(i) beneficial ownership of 10 percent or more of the outstanding [voting securities] common equity of an entity, including any right to receive such securities within 60 days of the [effective date of] member's participation in the public offering;

(ii) [beneficial ownership of] the right to 10 percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the [effective date of] member's participation in the public offering; [or]

(iii) beneficial ownership of 10 percent or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member's participation in the public offering;

(iv) beneficial ownership of 10 percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or

([iii]v) the power to direct or cause the direction of the management or policies of an entity.

(B) No Change.

(6) through (7) renumbered (7) through (8).

(9) Preferred Equity

The term "preferred equity" means the aggregate capital invested by all persons in the preferred securities 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.

(10) 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 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.

(8) renumbered as (11).

([9]12) Qualified Independent Underwriter

The term "qualified independent underwriter" means a member:

(A) No Change.

(B) that does not beneficially own as of the date of [filing of the registration statement and the effective 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) No Change.

(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 in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) through (ii) No Change.

(iii) has been suspended or barred from association with any member by an order or decision of the Commission, any state, [NASD] 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.

(13) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act of 1933; notification on Form 1A filed with the Commission pursuant to the provisions of SEC Rule 252 under the Securities Act of 1933; 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.

* * * * *

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.[1]

* * * * *

5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

5110. 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 NASD Rule 2720 are incorporated herein by reference.

(1) through (10) No Change.

(11) Company

A corporation, a partnership, an association, a joint stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such.

(12) Effective Date

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[1] The original filing submitted on September 6, 2007 proposed to amend NASD Rule 2710. On September 11, 2008, the SEC approved proposed rule change SR-FINRA-2008-039, in which FINRA proposed, among other things, to adopt NASD Rule 2710 as FINRA Rule 5110 in the Consolidated FINRA Rulebook. See Securities Exchange Act Release No. 58514 (September 11, 2008), 73 FR 54190 (September 18, 2008) (order approving SR-FINRA-2008-039). SR-FINRA-2008-039 was implemented on December 15, 2008. See Regulatory Notice 08-57 (October 2008).

The date on which an issue of securities first becomes legally eligible for distribution to the public.

(13) Immediate Family

The parents, mother-in-law, father-in-law, 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 any other person who either lives in the same household as, provides material support to, or receives material support from, an employee or associated person of a member.

(14) Person

Any natural person, partnership, corporation, association, or other legal entity.

(b) Filing Requirements

(1) through (6) No Change.

(7) Offerings Exempt from Filing

Notwithstanding the provisions of subparagraph (1) above, documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of NASD Rule 2720(a)(2). However, it shall be deemed a violation of this Rule or NASD Rule 2810, for a member to participate in any way in such public offerings if the underwriting or

other arrangements in connection with the offering are not in compliance with this Rule or NASD Rule 2810, as applicable:

(A) through (G) No Change.

(8) through (9) No Change.

(c) through (g) No Change.

[**(h) Proceeds Directed to a Member**]

[**(1) Compliance With NASD Rule 2720**]

[No member shall participate in a public offering of an issuer's securities where more than 10% of the net offering proceeds, not including underwriting compensation, are intended to be paid to 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 NASD Rule 2720(c)(3).]

[**(2) Disclosure**]

[All offerings included within the scope of paragraph (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.]

[**(3) Exception From Compliance**]

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

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

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

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

[(D) an offering of securities subject to NASD 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.]

(i) through (j) redesignated as (h) through (i).

* * * * *

Rule 2720 is replaced in its entirety by the following proposed rule language.

2720. Public Offerings of Securities With Conflicts of Interest

(a) Requirements for Participation in Certain Public Offerings

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraphs (1) or (2).

(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) the member(s) 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 requirement of paragraph (f)(12)(E);

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

(C) 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.

(2) (A) 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 conflict of interest;

(ii) the name of the member acting as qualified independent underwriter; and

(iii) a brief statement regarding the role and responsibilities of the qualified independent underwriter.

(b) Escrow of Proceeds; Net Capital Computation

(1) All proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with subparagraph (2) hereof.

(2) Any member offering its securities pursuant to this Rule shall immediately notify FINRA when the public offering has been terminated and settlement effected and shall file with FINRA a computation of its net capital computed pursuant to the provisions of SEC Rule 15c3-1 under the Act (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the member calculates its net capital requirement using the alternative standard (set forth in Rule 15c3-1(a)(1)(ii)), its net capital is less than seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, all monies received from sales of securities of the public offering must be returned in full to the purchasers thereof and the offering withdrawn, unless the member has obtained from the Commission a specific exemption from the net capital rule. Proceeds from the sales of securities in the public offering may be taken into consideration in computing net capital ratio for purposes of this paragraph.

(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 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) is subject to Rule 5110, whether or not the offering would be otherwise exempted from the filing or other requirements of that rule.

(e) Requests for Exemption from Rule 2720

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this rule that 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) Affiliate

The term "affiliate" means an entity that controls, is controlled by or is under common control with a member.

(2) Beneficial Ownership

The term "beneficial ownership" means the right to the economic benefits of a security.

(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 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 Regulation M under the Act) 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.

(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 associated persons;

(C) at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be:

(i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or

(ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate; or

(D) as a result of the public offering and any transactions contemplated at the time of the public offering:

(i) the member will be an affiliate of the issuer;

(ii) the member will become publicly owned; or

(iii) the issuer will become a member or form a broker-dealer subsidiary.

(6) Control

(A) The term "control" means:

(i) beneficial ownership of 10 percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member's participation in the public offering;

(ii) the right to 10 percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering;

(iii) beneficial ownership of 10 percent or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member's participation in the public offering;

(iv) beneficial ownership of 10 percent or more of the outstanding preferred equity of an entity, including any right to

receive such preferred equity within 60 days of the member's participation in the public offering; or

(v) the power to direct or cause the direction of the management or policies of an entity.

(B) The term "common control" means the same natural person or entity controls two or more entities.

(7) Entity

For purposes of the definitions of affiliate, conflict of interest and control under this Rule, the term "entity":

(A) includes a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons; and

(B) excludes the following:

(i) an investment company registered under the Investment Company Act of 1940;

(ii) a "separate account" as defined in Section 2(a)(37) of the Investment Company Act of 1940;

(iii) a "real estate investment trust" as defined in Section 856 of the Internal Revenue Code; or

(iv) a "direct participation program" as defined in Rule 2810.

(8) Investment Grade Rated

The term “investment grade rated” refers to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

(9) Preferred Equity

The term “preferred equity” means the aggregate capital invested by all persons in the preferred securities 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.

(10) 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 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.

(11) Public Offering

The term “public offering” means any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition and all other securities offerings of any kind whatsoever, except any offering made pursuant to:

(A) an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act of 1933;

(B) SEC Rule 504, if the securities are “restricted securities” under SEC Rule 144(a)(3), SEC Rules 505 or 506; or

(C) SEC Rule 144A or Regulation S.

The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Act.

(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 of 1933, 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 in a supervisory capacity who are 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 Commission, 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.

(13) Registration Statement

The term "registration statement" means a registration statement as defined by Section 2(a)(8) of the Securities Act of 1933; notification on Form 1A filed with the Commission pursuant to the provisions of SEC Rule 252 under the Securities Act of 1933; 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.

* * * * *