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July 14, 2017

Re: **FINRA Regulatory Notice 17-15**
Request for Comment on Proposed Amendments to FINRA's Corporate Financing Rule

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

Dear Ms. Mitchell:

We are writing in response to the request for comment in Regulatory Notice 17-15 with respect to proposed amendments to FINRA Rule 5110. While we generally support the amendments, we do not feel they go far enough to accomplish the goals set forth in the notice. Our specific recommendations are below.

Recommendations.

(A) Exemptions from the filing requirements. We believe the following exemptions from the filing requirements of the rule will modernize the rule and lessen burdens on members and issuers.

(1) Exemption from filing for Offerings on Form S-3, F-3 and Certain IPOs

We recommend that the rule be amended to add an exemption from the filing requirements for any offering on Form S-3 or F-3 or any initial public offering (i) of an issuer controlled by a venture capital or private equity fund with $100 million in assets under management or (ii) with proceeds of $75 million or more (collectively, the "Exempted Offerings"). We do not believe staff review of the underwriting terms and arrangements of the Exempted Offerings is necessary because these issuers are sophisticated professional negotiators. In addition, in the case of S-3 and F-3 eligible issuers, investors have immediate access to company disclosure through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators). Accordingly, neither issuer or investor protection should be a concern with respect to the Exempted Offerings. Finally, this exemption will free up FINRA staff to focus on offerings that are more likely to present regulatory problems.

Historical basis for the filing requirements and exemptions. The filing requirements of the Corporate Financing Rule can be traced back to the December 1961 recommendations of the Committee on Underwriting Arrangements of the NASD Board (later called the Corporate Financing Committee) that the Association review underwriting compensation of offerings of unseasoned companies. As they stated, "the Committee will continue to review the offerings of unseasoned companies, the sole test being whether or not, taking into account all elements of compensation and all of the surrounding circumstances, the arrangements as a whole appear unfair and unreasonable..."[1]

The filing requirements under the Corporate Financing Interpretation (the Interpretation), the predecessor to the Corporate Financing Rule, were much more expansive. They originally applied to all public offerings in which members participated in a distributive or advisory capacity, with the exception of straight debt issues rated "B" or better.

In 1983, when the NASD began to consider codifying the Interpretation into a rule, the Corporate Financing Committee recommended that the filing requirements be modified by focusing on the characteristics of the issuer of the securities rather than those of the securities being offered. The Committee observed that underwriting compensation in connection with offerings of equity securities of seasoned issuers seldom approached NASD limitations. They found that "those arrangements are negotiated by sophisticated professional negotiators on the issuer and the investment banker sides. Such negotiations can be expected generally to result in a highly competitive underwriting arrangement."[2] They concluded that NASD review of these arrangements was "extraneous."

The Committee requested that the staff consider a return to the historical approach of limiting corporate financing review to less seasoned issuers. By doing so, they noted that the NASD's resources could be used more efficiently on areas that did need surveillance because they might present regulatory problems.

Consistent with the recommendations of the Corporate Financing Committee, the Corporate Financing Interpretation was amended in 1983 to exempt shelf offerings on Form S-3. The Corporate Financing Rule, which was adopted in 1986, also included exemptions for investment grade rated debt and offerings of issuers with certain investment grade rated debt or preferred stock outstanding.

As stated in NASD Notice to Members 83-12, the shelf exemption "was adopted because it was believed that NASD advance review of these transactions would serve little regulatory purpose" and because "the competitive pressures which come into play in the negotiations preceding the execution of [the underwriting] agreement usually can be relied upon to achieve the overall fairness of the arrangement." The rationale for the exemption was further described in Notice to Members 88-101: "The Committee determined to exempt from the filing requirements securities registered on Form S-3 because an issuer able to satisfy Form S-3's 'registrant requirements' would be followed closely by investors and market professionals. The Committee also felt that the securities markets would efficiently determine a fair price for the securities being offered and that any underwriting compensation received by members ordinarily would be determined under very competitive circumstances."

[1] NASD Manual (1982) at page 115.

[2] Report to the Subcommittee to Review Filing Requirements (September 20, 1982).

Current analysis of the filing requirements and exemptions. We believe the filing requirements should be reconsidered in view of their historical objectives. As stated above, the Corporate Financing Committee has always taken the position that the review of the underwriting arrangements of offerings of seasoned issuers was unnecessary. Seasoned issuers were defined in the 1980s as registrants "closely followed by investors and market professionals." We believe the determination of what constitutes a seasoned issuer should be reevaluated in view of the significant technological advances since that time.

Today, issuers that are Form S-3 or F-3 eligible may be easily followed by investors and market professionals through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators). They have sufficient bargaining power to ensure that they will not be subjected to unfair or unreasonable underwriting arrangements. In addition, they are likely to be repeat issuers of securities and therefore have future business they will withhold from underwriters unwilling to give them competitive market terms. Review of the underwriting arrangements for these offerings would appear to be extraneous.

Large private equity and venture capital firms have significant negotiating experience and are frequent market participants. They do not need the protection of the Corporate Financing Rule to ensure the fairness of the underwriting terms of the IPOs of issuers they control. We also question whether the rule is needed to protect the issuers of IPOs with proceeds of $75 million or more. Numerous underwriters court issuers for IPOs of this size. This competition ensures that the underwriting terms of such offerings will be fair and reasonable.

(2) Exemption from filing for Shelf Offerings on Forms S-3/F-3/F-10.

Should you decide not to grant the request in item 1 above, we recommend that the proposed exemption from filing for shelf offerings be expanded. The exemption for shelf offerings on Form S-3 in the proposed new rule has been available since March 1983, under the Corporate Financing Interpretation. The exemption went into effect approximately one year after Form S-3 was originally adopted by the SEC. Since that time, the SEC has expanded the eligibility criteria of Forms S-3 and F-3 on two occasions, in 1992 and 2008, in order to permit more companies to cost effectively and expeditiously access capital in the public markets.[3]

In 1992, when the SEC reduced the public float requirement to $75 million under the S-3/F-3 eligibility criteria, the Commission determined that a large majority of the companies that would become eligible to use these forms as a result of this change had securities traded on a national securities exchange or authorized for inclusion on the NASDAQ National Market System and that roughly two-thirds of the companies were followed by at least three research analysts. "This, combined with the success of the 10 year-old integrated disclosure system and shelf registration

[3] In addition, on July 26, 2011, in response to requirements in the Dodd-Frank Act, the SEC amended the transaction eligibility criteria for registering primary offerings of non-convertible debt securities on Form S-3 and F-3. Specifically, they replaced the requirement that the securities be rated investment grade with four alternative provisions. They are that the issuer (i) has issued, for cash, more than $1 billion in non-convertible securities, other than common equity, through registered primary offerings over the prior three years, (ii) has outstanding at least $750 million of non-convertible securities, other than common equity, that were issued through registered primary offerings for cash, (iii) Is a wholly-owned subsidiary of a well-known seasoned issuer (WKSI) as defined under the Securities Act or (iv) is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI.

process, persuaded the SEC that it could extend the benefits of Form S-3 for primary offerings to a larger class of issuers without compromising the investing public's access to sufficient and timely information about such issuers."[4]

The fact that FINRA has not amended the shelf exemption in the Corporate Financing Rule to reflect the revised SEC eligibility criteria makes access to capital more expensive and adds an administrative burden we no longer feel is justified. In 1993 (in NASD Notice to Members 93-88), the NASD committed to "undertake a one-year review of offerings filed with the NASD on registration statement Form S-3…by companies that would not meet the…[eligibility] criteria for Form S-3 [in effect prior to October 21, 1992] to determine whether the market forces related to such offerings result in the presence of fair and reasonable underwriting terms and arrangements." In the absence of a recent study establishing a basis for not expanding the exemption to shelf offerings on current Forms S-3 and F-3, we propose the rule be so modified.

Specifically, we believe the shelf exemption in the new Corporate Financing Rule should be modernized to reflect, at a minimum, the October 21, 1992 S-3/F-3 eligibility requirement of a public float of $75 million (from the $150 million requirement for S-3 issuers and $300 million worldwide public float requirement for F-3 issuers in the current and proposed rule) or better still, to eliminate the public float requirement entirely, in accordance with current S-3/F-3 eligibility criteria. The rationale underlying the public float requirement in Form S-3, as originally adopted, was to protect investors by ensuring that only companies that were widely followed should benefit from short form registration. Similarly, as stated above, the NASD justified the exemption from filing for S-3 shelf issuers on the basis that "an issuer able to satisfy Form S-3's 'registrant requirements' would be followed closely by investors and market professionals…and any underwriting compensation received by members ordinarily would be determined under very competitive circumstances" (Notice to Members 88-101).

The significant technological advances since 1983, in terms of access to company disclosure through EDGAR, issuer websites and third party analysis (such as securities analysts and commentators) permit investors to closely follow any company in which they are interested. Public float is no longer a hallmark of negotiating strength, as is evidenced by the fact that the average underwriting commission on offerings from Form S-3 and F-3 shelf registration statements is just a fraction of what FINRA permits.

Similarly, we believe the requirement in the exemption that the issuer have reported, under the Exchange Act, for three years be modified to one year, as is the case with current Forms S-3 and F-3. When eligibility for these forms required a three year reporting history, investors did not have the ability to access documents incorporated by reference into the registration statement. Now that technology provides investors with immediate access to such information, a three year reporting history does not provide any benefit.

It has been 34 years since the NASD, now FINRA, determined the eligibility criteria for an exemption for shelf filers. In view of the fact that the stated purpose of FINRA's review of the Corporate Financing Rule is to modernize the rule and "reduce administrative and operational burdens," we believe it is appropriate to make the requirements for this exemption consistent with

[4] Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3, Release No. 33-8812 (June 20, 2007)[72 FR 35118].

the current eligibility criteria of Forms S-3, F-3 and F-10[5]. The competitive nature of negotiations between these issuers and underwriters assures that underwriting terms and arrangements in connection with shelf offerings will be fair and will not compromise issuer or investor protection.

(3) Exemption from filing for WKSI offerings.

While it has been very helpful that FINRA has streamlined the process for qualifying WKSI offerings, we question whether FINRA's goal of investor protection is furthered by the requirement to file such offerings. As you know, FINRA requires very little information to be provided in WKSI filings, reflecting the fact that it is unlikely that the interests of issuers or investors could be compromised in such offerings. The point of the SEC's WKSI initiative was to make access to capital less expensive. We believe this should be FINRA's goal as well.

(4) Exemption from filing for offerings exempt from Rule 5110 but subject to filing under Rule 5121.

We recommend an exemption from filing for offerings that are exempt from filing under the Corporate Financing Rule but subject to filing under the conflict rule. We believe the requirements of Rule 5121 adequately address investor protection concerns and that no additional protection is provided by review of the offering by the Corporate Financing Department. The increase in transaction costs and potential for delay resulting from review are simply not justified. We further note that conflicts are often discovered late in the process leading up to an offering, because, for example, the offering size determined by the market causes the lead underwriter to have a conflict of interest (i.e., it is determined that a lender, affiliated with the lead underwriter, will be repaid more than 5% of the net offering proceeds), at which point the FINRA filing imposes a significant administrative burden.

(5) Exemption from filing for certain convertible debt offerings.

Since the early 1990s, FINRA's Corporate Financing Department has granted exemptions, in response to individual requests, for convertible debt of an issuer that has outstanding investment grade rated debt of the same class as that being offered if there is a bona fide public market in the common stock underlying the debt.

We believe this exemption should be added to the rule or the supplementary material to the rule since any issuer/investor protection concerns for such offerings are fully addressed (i.e., the debt meets the exemption in Rule 5110(b)(7)(B) and the underlying common stock generally meets the exemption in Rule 5110(b)(7)(A)). If FINRA determines that this exemption should only be

[5] The eligibility criteria for Form F-10 in effect on June 21, 1991 required the registrant to have a public float of at least Cdn. $75 million and equity securities with a market value of at least Cdn. $360 million. It also required reconciliation of financial statements to U.S. GAAP. Subsequently, the SEC eliminated the market value requirement from the eligibility criteria and eliminated the GAAP reconciliation requirement at the same time as the SEC eliminated the investment grade security requirement from the S-3/F-3 eligibility requirements for straight debt and preferred stock, (see footnote 3). The SEC eliminated the GAAP reconciliation requirement because of 2011 changes to Canadian regulations requiring Canadian filers to prepare their financial statements pursuant to International Financial Reporting Standards ("IFRS"). It seems odd that FINRA's exemption is conditioned on GAAP reconciliation when Canadian regulations require IFRA financials. In addition, the $75 million public float requirement should be sufficient to assure FINRA that these issuers have sufficient bargaining power to protect themselves from overreaching by underwriters.

granted upon request, the availability of the exemption should be discussed in the rule's Supplementary Material to improve administration of the rule for all members.

(6) Exemption from filing for block trades.

We believe an exemption for block trades should be added to the rule in view of the highly competitive nature of negotiations between issuers and underwriters in connection with these offerings. Such negotiations assure that underwriting terms and arrangements will be fair and will not compromise issuer or investor protection.

(7) Exemption from filing for takedowns from shelf offerings required to be filed.

While it has been helpful that FINRA has, in the past few years, streamlined the process for qualifying shelf offerings, we recommend that FINRA eliminate the requirement to file prospectus supplements and accompanying documents on shelf offerings subject to the filing requirements, given that such documents are largely available on EDGAR. Instead of such filings, FINRA can require that counsel undertake, at the time of filing the shelf registration statement, to obtain representations from members that underwriting compensation will not exceed 8% of gross offering proceeds and that members will not engage in any prohibited arrangements in connection with any takedown from the shelf. This is consistent with FINRA's current practice not to require takedowns to be filed in connection with WKSI offerings.

(8) Exemption from filing for dribble out offerings.

We believe it has been FINRA's longstanding position that no filing is required for shelf offerings registered for the benefit of selling shareholders that are intended to be sold in ordinary market transactions by members acting as agents. It would be helpful for administration of the rule if there were an exemption for these offerings.

(B) Defined terms.

We appreciate the inclusion of new defined terms in the amended rule but believe certain modifications should be made to those definitions.

(1) Underwriting compensation.

(a) "in connection with" vs. "in the review period"

You are proposing to define the term "underwriting compensation" as "any payment, right, interest, or benefit received or to be received by a participating member from any source for underwriting, allocation, distribution, advisory and other investment banking services in connection with a public offering." We believe this definition should be modified to replace the term "in connection with the offering" with "in the review period."

It is necessary that you add "in the review period" to the definition because items of value received by a participating member before the review period are not underwriting compensation. Further, we believe the use of the term "in connection with the offering" is potentially misleading because in this context, it does not necessarily have its literal meaning. For example, if an affiliate of a prospective underwriter purchases securities of an issuer during the review period, those securities are underwriting compensation under the rule, notwithstanding the fact that there may be no connection between the purchase and the public offering. For the same reason, as discussed below, the term "related to the public offering" should be deleted from the proposed rule.

(b) "related to"

To determine whether straight debt or derivative instruments are underwriting compensation, the test in the proposed rule is whether such securities were acquired in a transaction "related to the offering." There is no definition of "related to the offering" and we believe the test in the current rule, which is whether such securities were acquired at a fair price, provides a much more meaningful standard.

In 2004, the Corporate Financing Rule underwent a major revision, one of the purposes of which was to eliminate the need for subjective determinations of whether items of value were acquired "in connection with" or "related to" the offering and provide a more objective standard for members and the Corporate Financing Department to determine what constitutes underwriting compensation. The proposed rule appears to be going back to the pre-existing rubric, which members found to be so inconsistent and troublesome. We believe this is a mistake, particularly if no definition of "related to the offering" is contained in the rule.

We further note that for most of the rule's history, straight debt has not been treated by the Corporate Financing Department as underwriting compensation. We believe that approach should be reflected in the proposed rule. It is difficult to envision a situation in which non-convertible debt could be used as underwriting compensation, unless the interest rate was above the prevailing rate. However, no company seeking to go public would enter into such an arrangement because of its glaring unfairness.

(c) "from any source"

We further request that you modify the definition of underwriting compensation to delete compensation received "from any source." In the alternative, that phrase should be replaced with more limited language. Under the proposed definition, securities acquired, for example, by an affiliate of a member from a former employee of the issuer are deemed underwriting compensation. Regulation of a third party, arms' length sale of securities to an affiliate of an underwriter should be outside the scope of the rule. Regulating such sales does not further issuer or investor protection.

We also recommend that the definition be modified to exclude securities of foreign issuers acquired by participating members in the issuer's domestic market if such market meets certain volume and float requirements. We believe the requirement proposed in the rule (i.e., that the domestic market be a "designated offshore securities market" as defined in Rule 902(b) of Regulation S) is overly restrictive and not meaningful. The real issue is whether the securities are freely trading so that the price paid is the fair market price. For the same reason, the requirement in proposed section (a)(4)(B)(v) should be modified so that participating members need not provide information with regard to securities they acquire during the review period in the issuer's domestic market.

(2) Review period.

Requirement to notify FINRA regarding items of compensation received post-offering.

Because the review period is defined to include the 60 day period following the effective date of a firm commitment offering (or closing or final closing for other offerings), participating members will be required to provide FINRA with information regarding any fees or other compensation received by them, their affiliates, associated persons and immediate family of associated persons for 60 days following the offering. We believe the scope of this requirement imposes a significant diligence burden.

While the Supplementary Material to the proposed rule sets forth examples of payments that are not deemed underwriting compensation (e.g., compensation for commercial banking services as well as brokerage, trust and insurance services to the issuer), the requirement to question every affiliate of an underwriter as to services performed and compensation received during the 60 day post-offering period is unduly burdensome.

(3) Required Filing Date.

We believe the definition of required filing date should be modified with respect to offerings that are dormant for a period of six months or more. Offering delays are often attributable to poor market conditions and cash strapped pre-IPO companies often have to seek private financing from entities that may be participating members, in which case the securities acquired by such members are underwriting compensation. Because the exceptions from underwriting compensation are unavailable for securities acquired by participating members after the first confidential submission to or public filing of the registration statement with the SEC, (whichever is earlier), an issuer may not be able to accept financing from a participating member because of potentially excessive underwriting compensation. This is a terrible result, which we believe FINRA did not intend. Accordingly, either the definition of required filing date should be modified or the exceptions from underwriting compensation should be modified to apply to acquisitions by participating members of the issuer’s securities after the required filing date. If the former, we would suggest that the definition provide that with respect to offerings that are dormant for six months or more, the review period begin upon the filing of the first amendment to the registration statement, which has been confidentially or publicly filed with the SEC, following the dormant period.

(4) Institutional Investor.

While the exceptions from underwriting compensation in the existing rule and sections (c)(2) and (c)(3) of the revised rule are, on their face, very helpful and rational from a regulatory perspective, the definition of institutional investor makes these exceptions difficult to impossible to establish. Specifically, a significant diligence burden is caused by the requirement in the definition that the aggregate interest of participating members be less than 5% for a publicly owned entity and 1% for a nonpublic entity. If the entity is a publicly owned corporation, for example, diligence is required with respect to the FINRA affiliation or association of every shareholder of the corporation in order to determine if the 5% threshold is met. With a private limited partnership, the same sort of diligence is required for every limited partner. This is often an impossible burden, which negates the availability of the exceptions from compensation.

(C) Exclusions from underwriting compensation.

(1) Securities issued under compensatory benefit plans or arrangements.

We ask that the exclusion from underwriting compensation for securities acquired pursuant to an employee benefit plan qualified under section 401 of the Internal Revenue Code "or a similar plan" be clarified and expanded. We are making this request because many employee benefit plans or compensatory arrangements of pre-IPO issuers are not qualified under section 401. If you are unwilling to provide an exemption for securities issued to employees and directors under any compensatory arrangement, we ask that you provide an exemption for securities granted or issued under a bona fide benefit plan or compensatory arrangement, as evidenced by the simultaneous grant or issuance to a substantial number of employees or directors that are not participating members or pursuant to the issuer's ordinary course of business (e.g., annual, semi-annual grants or quarterly issuances rather than isolated issuances to a participating member). If you decide to adopt this approach, we recommend that you require a representation from counsel that the grant or issuance is in compliance with the rule rather than requiring FINRA staff to perform this analysis, which is time consuming and may result in delay of the offering. In the alternative, we suggest that securities issued in reliance upon SEC Rule 701 be excluded from compensation. Such a change would reduce the burden of attempting to verify to the Corporate Financing Department that securities issuances or grants of compensation to employees were bona fide and not underwriting compensation.

(2) Securities issued pursuant to court order.

We request that the rule be modified so that securities issued to participating members pursuant to a court order be excluded from underwriting compensation. Such distributions do not require regulation by FINRA as they are not made at the discretion of the issuer.

(3) Fee payments to foreign broker-dealers affiliated with US underwriters.

The rule is unclear as to whether to treat as underwriting compensation fees paid by the issuer to foreign broker-dealers affiliated with participating members for services provided during the review period. We believe cash fees and other compensation paid in connection with the foreign distribution of the offering should not be deemed underwriting compensation.

(D) Lock-up Restrictions.

(1) We believe the expansion of the lock-up restrictions to include straight debt and derivative instruments is not justified and may interfere with some derivative transactions. As stated by NASD former vice chairman Mary Schapiro, "Lock-up requirements may be imposed to bring underwriting compensation into compliance with NASD guidelines and to protect investors in IPOs from the potential for dilution and manipulation if underwriters were to sell large amounts of an IPO issuer's shares into the aftermarket...firms' failure to have policies in place to ensure compliance with the rules and to minimize the opportunity for underwriters and related persons to realize a quick profit from the sale of pre-IPO shares hurt[s] the integrity of the underwriting

process and the confidence of investors."[6] We do not believe these concerns are present in the context of straight debt and derivative instruments acquired as compensation.

(2) We also question the need for extending the lock-up restrictions to underwriting compensation acquired in offerings of debt and derivative instruments. There seems to be no rationale for such expansion and the concerns discussed above do not appear to be present in such offerings.

(E) Clarification of certain matters.

(1) Please provide clarification as to the specific disclosure requirements for securities acquired by participating members that are deemed underwriting compensation. We assume the member(s) that acquired the securities must be named. Are we also required to disclose the class of securities, number of securities and/ or the compensation value of the securities?

(2) Please clarify whether we are required to file information with respect to unvested securities acquired by participating members during the review period. We believe such securities should not constitute underwriting compensation as it is unclear whether the conditions precedent to vesting will ever be satisfied.

(3) Section (a)(4)(A)(iii) of the proposed rule provides that amended documents "containing changes to the offering and underwriting terms and arrangements" are required to be filed. We believe it was FINRA's intention that this provision reduce the number of documents required to be filed. If that is the case, we suggest that the reference to "offering" be deleted, which is appropriate since the Corporate Financing Rule focuses solely on underwriting terms and arrangements. In that connection, we further suggest that the rule be amended to exclude from the filing requirements any exhibit volume containing materials unrelated to the underwriting terms and arrangements. Since the registration statement includes a list of the exhibits, should the Corporate Financing Department be interested in an exhibit that was not filed, it can request the filing of the document in the review process.

(4) The Supplementary Materials provide that fees of independent financial advisers are excluded from underwriting compensation. What about fees paid to members for acting solely as financial advisers?

We appreciate the opportunity to comment on the rule. Should you have any questions regarding the foregoing, please do not hesitate to contact Michael Kaplan at 212-450-4111, Joseph Hall at 212-450-4565, Richard Truesdell at 212-450-4674 or Marcie Goldstein at 212-450-4739.

Sincerely,

Davis Polk & Wardwell LLP

[6] FINRA News Release, NASD Fines Morgan Stanley $2.7 Million for IPO Lock-Up Violations; J.P. Morgan to Pay $150,000, Goldman Sachs $125,000 for Similar Violations (June 9, 2005).