Regulatory Notice 24-17

Capital Formation

FINRA Requests Comment on Proposed Changes to Corporate Financing Rules

Comment Period Expires: March 20, 2025

December 20, 2024

Notice Type

- Request for Comment

Suggested Routing

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

Key Topic

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

Referenced Rules & Notices

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

Summary

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

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

Questions concerning this *Notice* should be directed to:

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

Action Requested

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

Comments must be submitted through one of the following methods:

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

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

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

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

Background & Discussion

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

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

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

Proposed Amendments to Rule 5110

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

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

Valuation Method for Securities Acquisitions Considered Underwriting Compensation

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

Safe Harbors From Underwriting Compensation for Certain Securities Acquisitions

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

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

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

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

Debt-for-Equity Exchanges

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

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

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

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

Non-Convertible Preferred Securities

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

Operational Changes

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

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

Proposed Amendments to Rule 5121

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

"Bona Fide Public Market" Exception to the QIU Requirement

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

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

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

Obligations of a Conflicted Member and QIU

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

Additional Guidance to Participating Members

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

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

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

Proposed Amendments to Rule 5123

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

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

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

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

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

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

Economic Impact Assessment

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

Economic Baseline

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

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

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

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

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

Economic Impacts

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

Anticipated Benefits of Proposed Amendments to Rule 5110

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

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

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

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

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

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

Anticipated Costs of Proposed Amendments to Rule 5110

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

Proposed Amendments to Rule 5121

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

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

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

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

Proposed Amendments to Rule 5123

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

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

Request for Comment

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

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

Endnotes

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

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

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

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

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

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

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

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

9 *See* Rule 5110(c).

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

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

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

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

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

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

16 These "institutional" accredited investors are:

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

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

18 *See* 17 CFR § 230.501(a)(9).

19 *See* 17 CFR § 230.501(a)(12).

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

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

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

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

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

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

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