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March 20, 2025

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

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

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

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Introduction

Dear Secretary Jennifer Piorko Mitchell:

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

Clinic's Statement

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

Potential Benefits for Small Investors

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

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

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

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

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

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

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

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

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

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

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

Potential Risks for Small Investors

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

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

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

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

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[3] See FINRA, Private Placements Regulatory Obligations and Related Considerations, https://www.finra.org/rules-guidance/guidance/reports/2024-finra-annual-regulatory-oversight-report/private-placements.

[4] Private Placements - Rule 506(b), U.S. Securities and Exchange Commission (Nov. 14, 2024), https://www.sec.gov/resources-small-businesses/exempt-offerings/private-placements-rule-506b#:~:text=securities%20may%20not%20be%20sold,merits%20and%20risks%20of%20the.

[5] See FINRA, Firm Guidance – Private Placement Filings, https://www.finra.org/rules-guidance/key-topics/private-placements/filing-guidance.

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

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

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

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

Conclusion

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

[Signatures next page]

Respectfully Submitted,

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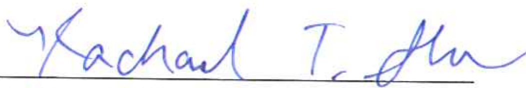

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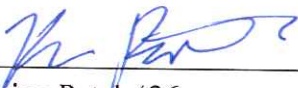

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