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Client Alert Commentary

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FINRA Issues Guidance and Sets Implementation Dates for Corporate Financing Rule Amendments

The amendments modernize, restructure, and streamline Rule 5110.

On March 20, 2020, the Financial Industry Regulatory Authority, Inc. (FINRA) published Regulatory Notice 20-10 (RN 20-10),[1] which provides additional guidance and timing for the implementation of sweeping amendments (Amendments) to FINRA's Corporate Financing Rule (Rule 5110). The Securities and Exchange Commission (SEC) formally approved the Amendments on December 23, 2019,[2] following multiple rounds of public comments and additional proposals, and after ongoing industry discussions and a retrospective rule review that FINRA launched more than six years ago, with the goal of modernizing and simplifying the rule to improve efficiency and better reflect current market practices.[3]

While certain changes to the filing requirements for public offerings are immediately effective with the publication of RN 20-10, **the bulk of the Amendments will not be implemented until September 16, 2020 (September Implementation Date)**.[4] FINRA staff stated that the additional time was needed to make technological adjustments to its online "Public Offering System" in order to reflect and implement the Amendments, and indicated that further changes are being made to the Public Offering System to simplify necessary manual user inputs and to streamline the review and approval process.

The Amendments primarily address the following:

- Filing Requirements — including changes as to timing, modifications to the Public Offering System, and addition of new exemptions from the filing and substantive requirements of the rule
- Underwriting Compensation — including addition of a definition of "underwriting compensation," significant changes to the so-called "Venture Capital Exceptions" and provision of Supplementary Materials to set forth specific items that FINRA does, or does not, deem to be underwriting compensation for purposes of the rule
- Lock-Up Restrictions — including new exclusions for securities acquired in transactions that meet the requirements of one of the Venture Capital Exceptions and securities issued by an issuer that meets the registration requirements of SEC Forms S-3, F-3, or F-10
- Prohibited Terms and Arrangements — including certain clarifying changes and a new exclusion for advisory or consulting fees from the prohibition on receipt of underwriting compensation in advance of consummation of the public offering

- Defined Terms — including consolidation of the relevant definitions into a single section at the end of the rule, addition of new definitions, clarifications to existing definitions, and elimination of certain redundant terms and definitions such as "items of value" and "underwriter and related persons"

Filing Requirements

As amended, Rule 5110 provides additional time to make required FINRA filings. Specifically, required FINRA filings must now be made within three business days (rather than one business day) following the date the registration statement or other document is filed with or confidentially submitted to the SEC.[5] In addition, the Amendments reduce the filing burden by allowing registration statements and other documents that have been filed with the SEC to be filed with FINRA, solely by providing the relevant EDGAR identification or "accession" number[6] and providing that amendments to previously filed offering documents need be filed only if they include changes that impact the underwriting terms and arrangements.[7] FINRA believes that providing additional time for filing, allowing the filing of documents via links to EDGAR, and limiting the number and types of documents required to be filed with FINRA in connection with a particular public offering will increase compliance and efficiency. **The aforementioned changes are the only elements of the Amendments that are effective immediately.**

As of the September Implementation Date, the Amendments also change some of the current required representations and supporting documents. Among other changes, public offering filings will need to include a representation as to whether any officer or director of the issuer, or any beneficial owner of 10% or more of any class of the issuer's equity and equity-linked securities, is an associated person or an affiliate of a participating member. This is a significant change from, and adds needed clarity to, the existing requirement, which calls for a representation as to the "association or affiliation" (terms not defined in the rule) of such persons with a participating member, has a 5% beneficial owner threshold, and encompasses all classes of the issuer's securities rather than only those that are equity or equity-linked.[8] In raising the threshold for beneficial ownership to 10% and limiting the scope to equity, this provision is now better aligned to the definition of "control" for purposes of the conflict of interest disclosure provisions of FINRA Rule 5121 (Rule 5121).

Amended Rule 5110 also includes a new provision that will require, in the case of a filed offering that is not completed according to the terms entered into between the issuer and a participating member (a terminated offering), the member to (i) provide written notification to FINRA of all underwriting compensation received or to be received pursuant to Rule 5110(g)(5) (which excludes from the general prohibition on receipt of underwriting compensation for terminated offerings, the receipt of certain types of compensation under specific circumstances) and (ii) file with FINRA any agreement governing the arrangement.[9] FINRA believes that any securities, unaccountable expenses, or termination fees received as part of the terminated offering should be considered underwriting compensation in connection with a "revised public offering" if that participating member participates in the revised public offering. Accordingly, FINRA believes it needs this information to ensure that a participating member is not compensated more than once for providing the same services.[10] Reimbursement received by a participating member for accountable expenses incurred in connection with a terminated offering, however, would not be counted as underwriting compensation for the revised public offering.

The Amendments clarify and codify certain generally understood existing practices, including the following:

- No FINRA member may engage in the distribution or sale of securities in an offering required to be filed under the rule until FINRA has provided a no objections opinion to the proposed underwriting terms and arrangements.[11]

- The managing underwriter of any offering subject to the rule must notify the other members participating in the offering if FINRA issues an opinion that the underwriting terms and arrangements are unfair and unreasonable and such proposed terms and arrangements have not been appropriately modified.[12]

- The filing of industry-standard master forms of agreement is not required in connection with a public offering unless such forms are specifically requested by FINRA.[13]

Rather than setting forth a non-exhaustive list of types of public offerings that require filing, amended Rule 5110 instead provides that a public offering in which a member participates must be filed for review unless subject to the provisions of Rule 5121(a)(2) or expressly exempt from filing under Rule 5110(h)(1) or (h)(2).[14] Many of the filing exclusions remain the same as under current Rule 5110, while certain others have been clarified or modestly expanded. Among the more significant changes that will take place as of the September Implementation Date are that filings (unless otherwise required by Rule 5121) will not be required for (i) offerings registered on SEC Form S-3, F-3, or F-10[15] by an "experienced issuer" (as discussed further below, the term "experienced issuer" is now defined and functionally replaces the "pre-1992 standard" referenced in the current rule); or (ii) exchange offers in which the securities being acquired are listed or convertible into securities listed on a national securities exchange[16] (current Rule 5110 does not include an exemption for exchange offers of securities that are convertible into listed securities). In addition, amended Rule 5110 expands the types of public offerings that are exempt from compliance with the rule in its entirety to include insurance contracts generally (the current rule exempts only certain variable annuity and modified guaranteed annuity contracts or life insurance policies), unit investment trusts, and issuer tender offers made pursuant to Rule 13e-4 under the Securities Exchange Act of 1934 (Exchange Act).[17]

For shelf offerings that are not otherwise exempt from the rule's filing requirements, the Public Offering System will be updated (as of the September Implementation Date) to require the filing only of the initial shelf or "base" registration statement and payment of the applicable FINRA filing fee; takedown offerings off the shelf (including the relevant prospectus supplements) will no longer need to be filed. In addition, the filing itself will be made by entering only the SEC-assigned registration statement number and Fed Wire reference number into the system, and the system will then pull all other required information to populate the data fields directly from EDGAR. FINRA clearance will be for the entire shelf at the outset and shelf takedowns will be able to proceed immediately following receipt of an automatically generated acknowledgement letter. FINRA believes these system enhancements will allow issuers greater flexibility to take advantage of favorable market conditions on a real-time basis. FINRA staff has indicated, however, that (as is the case today) FINRA will continue to scan SEC filings, may select particular offerings for post-filing review, and may follow up directly with participating members to request additional information or documentation. Pre-offering consultation with FINRA also remains available.

With respect to non-shelf offerings, FINRA staff has indicated that they are in the process of reducing the amount of information required to be submitted via the Public Offering System and are expanding the "limited review" program to encompass a wider category of eligible offerings. FINRA believes these

changes, which are expected to be rolled out with the September Implementation Date, will make for a more efficient and quicker clearance process.

Underwriting Compensation

The Amendments eliminate the current "item of value" concept and include a new definition of the term "underwriting compensation." Pursuant to amended Rule 5110, underwriting compensation is defined 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. In addition, underwriting compensation explicitly includes finder's fees, underwriter's counsel fees and securities."[18] Amended Rule 5110 also includes expansive Supplementary Materials, which provide additional context and guidance as to what the term underwriting compensation is intended to encompass. In this regard, FINRA notes that "payments or benefits are generally not underwriting compensation when received by members for providing services unrelated to the public offering and when the payments or benefits are consistent with those received by other similarly situated persons and customary and appropriate for the services provided."[19]

Much of the information included in Supplementary Material .01(a) with respect to what FINRA deems to constitute underwriting compensation is set forth elsewhere in the current rule, but it also contains certain helpful clarifications. Significantly, FINRA has added guidance providing that equity securities purchased during the review period by a participating member in a public offering will not be considered underwriting compensation if such securities are purchased at the public offering price and on the same terms as all others purchasing in the public offering.[20] Supplementary Material .01(a)(14) also now expressly states that FINRA considers "non-cash compensation, such as gifts, training and education expenses, sales incentives, and business entertainment expenses" to be underwriting compensation, and thus subject to the same disclosure and calculation requirements as other elements of compensation under the rule. Although arguably the express inclusion of these non-cash compensation items does not represent a change from the current rule (pursuant to which they would presumably be captured as "items of value"), these items may be difficult to track and quantify. Industry commenters had requested FINRA to exclude from this list those items that satisfied the requirements for exclusion from the limitations set forth under FINRA's "gifts and gratuities" rule (FINRA Rule 3220) and related interpretive guidance, but FINRA declined this request and other requested modifications to Rule 5110's non-cash compensation provisions, noting it was in the process of undertaking a more sweeping review of all of its "non-cash compensation" provisions and thus not inclined to make any substantive changes to these provisions at the present time. FINRA notes in RN 20-10, however, that "the restrictions on receipt of non-cash compensation set forth in Rule 5110 are not intended to limit or otherwise be inconsistent with other provisions in Rule 5110 that implicitly permit the receipt by participating members of non-cash compensation under appropriate circumstances."[21]

FINRA has also determined to retain the 1% compensation value assigned to rights of first refusal (ROFRs) to participate in future public offerings, private placements, or other financings,[22] despite certain commenters calling for its elimination on the grounds that such valuation was arbitrary and unnecessary and that disclosure of the existence and terms of the ROFR itself should suffice. FINRA has, however, clarified that a ROFR that is provided in connection with a prior financing but does not extend beyond the initial closing of the public offering currently under review, or that has already been included as underwriting compensation in a prior or concurrent public offering, will not be considered underwriting compensation for the public offering under review.[23]

Supplementary Material .01(b) expands substantially the list of items that FINRA does not deem to constitute underwriting compensation from what is contained in the current rule (though FINRA notes that

even this list is not exhaustive). Many of these items represent the codification of interpretive guidance provided over the years on a case-by-case basis, while others represent the formal acknowledgement that items received or acquired by FINRA members or their affiliates in the ordinary course of business are simply not reasonably related to the "underwriting, allocation, distribution, allocation or advisory and other investment banking services" provided in connection a public offering. Notably, as of the September Implementation Date, participating members will not be required to file information or include descriptions of any securities acquired during the review period that are excluded from characterization as underwriting compensation pursuant to Supplementary Material .01(b).

Some of the new or modified explicit exclusions from characterization as underwriting compensation set forth in Supplementary Material .01(b) (which, as noted above, will be effective as of the September Implementation Date)[24] include:

- Cash compensation for providing services for a private placement or for providing or arranging for a loan, credit facility, or for services in connection with a merger or acquisition (this exception broadens the scope of the current exception by acknowledging the provision of other private placement services in addition to acting as placement agent, as well as loan arrangement services)[25]

- Payment or reimbursement of legal costs resulting from a contractual breach or misrepresentation by the issuer[26]

- Securities of the issuer pledged as collateral for a bona fide loan[27]

- Compensation received through any stock bonus, pension, employee benefit plan, or profit sharing plan that qualifies under Section 401 of the Internal Revenue Code or a similar plan, including, but not limited to, an employee benefit plan as defined in Rule 405 of the Securities Act of 1933 (Securities Act) or a compensatory benefit plan or compensatory benefit contract exempt from registration pursuant to Securities Act Rule 701 (under the current rule, only Section 401 plans are explicitly excepted)[28]

- Securities acquired as the result of the exercise of options or warrants that were originally acquired prior to the review period[29]

- Securities acquired subsequent to the issuer's initial public offering in a transaction exempt from registration under Securities Act Rule 144A[30]

- Securities acquired in the secondary market by a participating FINRA member or its broker-dealer affiliates in connection with bona fide market making and customer facilitation activities[31]

- Securities acquired pursuant to a governmental or court-approved proceeding or plan of reorganization as a result of action by the government or court[32]

Amended Rule 5110 continues to require the disclosure of all items of underwriting compensation in the FINRA filing and the Underwriting or Plan of Distribution section of the prospectus. Supplementary Material .05, reflecting current requirements and guidance, provides that this disclosure must include a description (including the dollar amount) of each item of underwriting compensation received or to be received by a participating member. This reverses an earlier proposal stating that the dollar amount of certain items of compensation (other than the underwriting discounts or commissions) need not be disclosed. This reversal was apparently prompted by certain commenters who argued that such information was important to investors. RN 20-10 provides additional guidance as to how FINRA

determines whether the underwriting compensation for a particular offering is reasonable, basing that determination on the aggregate offering size, the distribution method, and whether the offering is an initial public offering or a follow-on, among other factors. Supplementary Material .05 also provides that participating members must disclose the material terms and arrangements with respect to the acquisition of securities by the member if such securities are deemed underwriting compensation for the public offering, including, as applicable, any exercise terms, demand and/or piggyback registration rights, and lock-up requirements. Disclosures with respect to ROFRs (see discussion above) must also specifically include a reference to their duration.

In light of the increasingly global nature of many public offerings, RN 20-10 offers additional guidance as to the inclusion and disclosure of underwriting compensation when a non-US non-member broker-dealer participates in a public offering alongside an affiliated FINRA member. In such cases, RN 20-10 provides that "[i]f the participating members are able to divide underwriting compensation so as to separately allocate the underwriting compensation received by the non-US broker-dealer for the non-U.S. portion of the global offering, FINRA considers that separately allocated underwriting compensation to be outside the scope of Rule 5110 and not subject to the requirements of Rule 5110."[33] RN 20-10 also confirms previous FINRA guidance that underwriting compensation paid to a non-US broker-dealer that is not itself a FINRA member or affiliated with a participating FINRA member will not be deemed to be underwriting compensation in connection with the public offering for Rule 5110 purposes.[34]

The Venture Capital Exceptions

Among the exceptions from characterization as underwriting compensation are securities acquired in certain transactions effected by a participating FINRA member or its affiliates for bona fide venture capital purposes. Effective as of the September Implementation Date, the Amendments modify certain of elements of the three main Venture Capital Exceptions, add a new exception relating to co-investments with certain regulated entities, and generally reorganize and simplify the existing provisions to provide greater clarity.[35] As is the case under the current rule, each of the Venture Capital Exceptions apply only to (i) securities acquired in transactions that occur prior to the initial required filing date for the public offering (except in the limited circumstances described below) and (ii) only under circumstances in which the member's participation in the public offering is not conditioned on the acquisition of such securities and the securities are acquired at the same price and with the same terms as the securities purchased by other investors. In addition, Supplementary Material .07 now explicitly confirms that the availability of a particular Venture Capital Exception is to be determined based on the circumstances at the time of the securities acquisition. RN 20-10 further explains that FINRA will consider "what the participating member knew, or reasonably should have known, at the time of a securities acquisition in assessing whether the securities acquisition may be excluded from underwriting compensation pursuant to the [Venture Capital Exceptions]."[36]

Two of the exceptions, "Purchases and Loans by Certain Affiliates" and "Investments in and Loans to Certain Issuers,"[37] are available for acquisitions by an affiliate of a participating member if that affiliate, among other requirements, is not a registered broker-dealer and is primarily engaged in the business of making investments or loans or is an entity that has been newly formed by such an affiliate. Although these exceptions currently include a 25% limitation with respect to the amount of the issuer's total equity securities that may be acquired, amended Rule 5110 removes this limitation, which dates from prior amendments to the rule adopted in 2004, as FINRA now believes that other regulatory changes, including changes to Rule 5121 that were adopted in 2009, have negated its necessity.[38]

The exception for "Private Placement with Institutional Investors"[39] is (as under the current rule) available for transactions by a participating member itself and permits the acquisition of securities in connection

with a private placement in which institutional investors (a term defined to exclude entities affiliated with any participating member) purchase at least 51% of the total securities sold in the private placement at the same time and on the same terms as the participating member, and in which an institutional investor was the lead negotiator or lead investor establishing or approving the terms of the placement.[40] However, the amended rule raises the current 20% limitation with respect to the aggregate amount of securities in the private placement that may be acquired under this exception by all participating members in the public offering to 40%.[41] This exception has also been expanded to include the acquisition of securities received as compensation for providing any services (rather than for solely acting as placement agent) in connection with a private placement.

Amended Rule 5110 includes a new exception for "Co-Investments with Certain Regulated Entities," and permits participating members to acquire securities in a private placement without such securities being counted as underwriting compensation for the public offering if at least 15% of the total number of securities sold in the private placement were acquired, at the same time and on the same terms, by one or more open-end investment companies not traded on an exchange (provided that no such entity is an affiliate of a participating FINRA member.[42] In including this new exception, FINRA reasoned that these other investors would be highly regulated entities with their own substantial disclosure requirements and independent directors who monitor their investments, lessening the risk that the participating member's securities acquisition was actually a disguised form of underwriting compensation.[43]

Amended Rule 5110 also provides that securities acquired by a participating member that are excluded from underwriting compensation pursuant to any of the Venture Capital Exceptions will not be subject to FINRA's lock-up restrictions (see discussion below with respect to other changes to these restrictions).[44]

As noted above, both the current and amended rule provide that the Venture Capital Exceptions apply only to those transactions that take place prior to the required filing date of the public offering. FINRA recognizes, however, that public offerings may be subject to significant delays beyond the issuer's control and that the issuer may require additional funding during this period. In these circumstances, or other appropriate situations, FINRA has indicated that it would take a principles-based approach and may expand the availability of the Venture Capital Exceptions to cover certain securities acquisitions by participating members or their affiliates occurring after the required filing date. More specifically, for a transaction that would otherwise meet the requirements of one of the Venture Capital Exceptions but for the timing element, FINRA may grant a waiver on the basis of the following considerations (as well as other relevant factors and circumstances):

- The length of time between the date of filing of the registration statement or similar document and the date of the transaction on which securities were acquired
- The length of time between the date of the transaction on which the securities were acquired and the anticipated commencement of the public offering
- The nature of the funding provided, including, but not limited to, the issuer's need for funding before consummation of the public offering[45]

Codifying prior guidance, FINRA will take a similar principles-based approach in determining whether securities of the issuer acquired by a participating member from third parties or through an issuer directed share program should be deemed underwriting compensation.[46] With respect to acquisitions from third parties, the participating member will need to provide FINRA with background information for the acquisition including: (1) the nature of the relationship between the issuer and the third party, if any; (2)

the nature of the transactions in which the securities were acquired, including, but not limited to, whether the participating member engages in the transactions as part of its ordinary course of business; and (3) any disparity between the price paid and the offering price or market price.[47] Similar considerations will apply when assessing whether securities acquired through issuer-directed share programs by a participating member's associated persons (or their immediate family members) should be included as underwriting compensation for a public offering.[48]

Lock-Up Restrictions

The Amendments clarify and add certain new exceptions to Rule 5110's lock-up restrictions. As of the September Implementation Date, amended Rule 5110 will provide (in addition to certain existing and continuing exceptions) exclusions for the following:

- Securities acquired from an issuer that meets the registration requirements of SEC Form S-3, F-3, or F-10[49]
- Non-convertible or non-exchangeable debt securities acquired in transactions related to a public offering[50]
- Derivative instruments acquired in connection with a hedging transaction related to a public offering at a fair price[51] (note, however, that other derivative instruments acquired in a transaction related to the public offering continue to be subject to the rule's lock-up restrictions)[52]
- Securities acquired in a transaction meeting any one of Rule 5110's Venture Capital Exceptions[53]
- Securities received as underwriting compensation that are registered and sold as part of a firm commitment offering[54]
- Securities that are "actively traded" (as defined in Rule 101(c)(1) of SEC Regulation M)[55]
- Transfers or sales of securities back to the issuer in a transaction exempt from registration with the SEC[56]

In addition, amended Rule 5110 expands the current exclusion allowing for the transfer of securities to any member participating in the offering and its officers or partners to also allow for transfers to a participating member's registered persons or affiliates, so long as in each case the transferred securities remain subject to the lock-up restrictions of the rule for the reminder of the 180-day lock-up period.[57]

Prohibited Terms and Arrangements

The Amendments clarify and update the list of prohibited terms and arrangements in connection with a public offering, but, for the most part, the current provisions remain in place substantially as is. One notable change is that, while amended Rule 5110 still generally prohibits any arrangement providing for the receipt of underwriting compensation prior to the commencement of sales of public offering, as of the September Implementation Date, the following will be permitted:

- Advances against accountable expenses actually anticipated to be incurred (which, to the extent not actually incurred, must be reimbursed to the issuer)[58]

- Payment of advisory or consulting fees for services provided in connection with the offering that is subsequently completed according to the terms of an agreement entered into by an issuer and a participating member[59]

Amended Rule 5110 also simplifies the current provision relating to limitations on payments made by an issuer to waive or terminate a ROFR to participate in a future capital-raising transaction by specifying only that such payment must be made in cash.[60]

Defined Terms

With the exception of the defined terms incorporated by reference from Rule 5121, amended Rule 5110 consolidates all of the applicable defined terms into a single section at the end of the rule. As noted above, for clarification and simplification purposes, certain terms have been eliminated (including the overbroad and redundant term "underwriter and related persons"), some existing defined terms have been modified, and several new defined terms have been added. All of these definitional changes are effective as of the September Implementation Date.

Notable among the new or modified defined terms are:

- Experienced Issuer: The inclusion of the new definition of "experienced issuer," which is used for purposes of the exemption from the filing requirements under paragraph (h) of amended Rule 5110, is intended to simplify the current rule by eliminating the reference to the "pre-1992 standards" applicable to registration on SEC Forms S-3, F-3, and F-10. As defined in the amended rule, an experienced issuer is an entity that has (i) a reporting history of 36 calendar months immediately preceding the filing of the registration statement; and (ii) at least US$150 million aggregate market value of voting stock held by non-affiliates; or alternatively the aggregate market value of the voting stock held by non-affiliates of the issuer is US$100 million or more and the issuer has had an annual trading volume of such stock of three million shares or more.[61]

  Although the terms used in FINRA's experienced issuer definition do not match entirely the corresponding terms or criteria used by the SEC for determining form eligibility, FINRA has indicated that "any guidance and interpretation, including, but not limited to, any guidance and interpretation on determining aggregate market value and public float, issued by the SEC or FINRA at adoption of or issued thereafter in connection with the pre-1992 standards for Forms S-3 and F-3 and standards approved in 1991 for Form F-10 to be valid and illustrative for purposes of interpreting the defined term 'experienced issuer.'"[62]

- Issuer: The term "issuer" has been modified to mean a registrant or other person that is offering its securities to the public, any selling security holder offering securities to the public, any affiliate of the registrant or such other person or selling security holder, and the officers or general partners, and directors thereof, but does not include a participating member unless the participating member is itself the registrant or a selling security holder offering its own beneficially held securities to the public.[63]

- Participating Member: The term "participating member" has been modified to mean 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.[64]

- Public Offering: The definition of "public offering" is being removed from Rule 5121 and relocated to amended Rule 5110 with certain modifications. As defined in the amended rule and subject to exclusions for certain specified private placements and other offerings, the term means any primary or secondary offering of securities made in whole or in part in the United States pursuant to a registration statement, offering circular, or similar offering document including exchange offers, rights offerings, and offerings of securities made pursuant to a merger or acquisition.[65] The specified exclusions include offerings of securities exempt from registration under Section 4(a)(1), 4(a)(2), or 4(a)(5) of the Securities Act, Rule 504 or 506 of SEC Regulation D, Securities Act Rule 144A, or SEC Regulation S, as well as securities defined as "exempted securities" in Exchange Act Section 3(a)(12).

- Review Period: In order to codify guidance relating to how the review period applies to different types of public offerings, the term "review period" is now formally defined as the 180-day period preceding the required filing date through the 60th day following the (i) effective date of firm commitment public offering; (ii) the final closing of a best efforts offering; or (iii) the final closing of a takedown or continuous offering made pursuant to Securities Act Rule 415.[66] (Note that the post-offering portion of the review period will, effective as of the September Implementation Date, be 60 days rather than the current 90 days.)

Conclusion

The Amendments reorganize and modify Rule 5110 in a number of significant ways. Moreover, the Amendments provide helpful clarifications and guidance with respect to the rule's filing and related requirements, including as to the types of items that FINRA will or will not consider to be underwriting compensation in connection with a public offering. FINRA has also streamlined the rule and is implementing changes to its Public Offering System to make the review and approval process more timely and efficient. However, the Amendments do not include all the modifications suggested by industry commenters and practitioners, and falls far short of the "disclosure only"-based rule suggested by some. While the Amendments thus represent welcome progress in the multi-year effort to clear the path of unnecessary obstacles in the way of capital formation, it is hoped that FINRA will continue to engage with the industry and explore other ways of refining the rule and related corporate financing regulations in order to improve the capital raising process even further.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Dana G. Fleischman
dana.fleischman@lw.com
+1.212.906.1220
New York

Stephen P. Wink
stephen.wink@lw.com
+1.212.906.1229
New York

Gail S. Neely
gail.neely@lw.com
+1.212.906.4578
New York

Edyta K. Hannas
Staff Attorney
edyta.hannas@lw.com
+1.212.906.2965
New York

Marta G. Talarek
Staff Attorney
marta.talarek@lw.com
+1.212.906.2949
New York

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Endnotes

1 *See* https://www.finra.org/rules-guidance/notices/20-10.

2 *See* SEC Release No. 34-87855 (Dec. 23, 2019); *see also* SR-FINRA -2019-012, available at https://www.finra.org/rules-guidance/rule-filings/sr-finra-2019-012.

3 *See* FINRA Regulatory Notice 17-15 (April 2017), available at https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-15.pdf (setting forth the original request for comments on comprehensive proposed amendments to Rule 5110 and noting in footnote 6 thereto that FINRA's review of the rule commenced prior to the formal retrospective rule review program launched in April 2014).

4 On March 12, 2020, FINRA filed an additional proposed rule change to Rule 5110 (in particular, with respect to its non-cash compensation provisions) in order to reflect new restrictions on the conduct of sales contests and certain other activities contained in the SEC's Regulation Best Interest. This rule change would be effective at the same time Regulation Best Interest becomes effective, which is currently set for June 30, 2020. *See* https://www.finra.org/sites/default/files/2020-03/SR-FINRA-2020-007.pdf.

5 *See* Rule 5110(a)(3)(A)(i).

6 *See* Rule 5110(a)(4)(A).

7 *See* Rule 5110(a)(4)(A)(iii). FINRA notes that "examples of documents that impact the underwriting terms and arrangements include those that reflect an increase or decrease to the anticipated offering size, method of distribution, and changes to the participating members or the services for which members are engaged." RN 20-10 at footnote 13.

8 *See* Rule 5110(a)(4)(B)(iii).

9 *See* Rule 5110(a)(4)(C) and Rule 5110(g)(5).

10 When assessing whether an offering is a "revised public offering," FINRA will look at the facts and circumstances of the offerings. See RN 20-10, p. 4.

11 *See* Rule 5110(a)(1)(C).

12 *See* Rule 5110(a)(1)(B).

13 *See* Rule 5110(a)(4)(A)(ii).

14 *See* Rule 5110(a)(2) and Rule 5110(h).

15 *See* Rule 5110 (h)(1)(C).

16 *See* Rule 5110(h)(1)(E).

17 *See* Rule 5110(h)(2)(E), (G) and (K).

18 *See* Rule 5110(j)(22).

19 RN 20-10 at p. 7.

20 *See* Supplementary Material .01(a)(7).

21 RN 20-10 at footnote 5.

22 *See* Supplementary Material .01(a)(9).

23 *See* Supplementary Material .01(b)(8).

24 FINRA staff has indicated that certain elements of the amended rule, such as those that are "principles-based" or that simply codify existing guidance may continue to be considered by FINRA and applied in advance of the September Implementation Date. However, any elements of the amended rule that are new or modify existing policy will not be able to be implemented (absent an additional rule-making process) prior to the September Implementation Date.

25 *See* Supplementary Material .01(b)(2).

26 *See* Supplementary Material .01(b)(4).

27 *See* Supplementary Material .01(b)(10).

28 *See* Supplementary Material .01(b)(12). FINRA has indicated that it interprets the reference to a "similar plan" in Supplementary Material .01(b)(12) to include "a written compensatory benefit plan for directors and employees that provides comparable grants of securities to similarly situated persons (e.g., a written compensatory benefit plan that provides comparable grants of securities to all qualifying employees). A 'similar plan' does not include a compensatory benefit plan that was developed or structured to circumvent the requirements of Rule 5110." RN 20-10 at footnote 40.

29 *See* Supplementary Material .01(b)(15).

30 *See* Supplementary Material .01(b)(20). Because these securities will no longer be deemed to constitute underwriting compensation for the public offering, the Amendments also eliminate the current carve-out for these securities from Rule 5110's lock-up requirements. *See* RN 20-10 at p. 14.

31 *See* Supplementary Material .01(b)(21).

[32] *See* Supplementary Material .01(b)(22).

[33] RN 20-10 at p. 8.

[34] See RN 20-10 at p. 8. Note, however, that disclosure of such compensation may still be required to be made pursuant to other provisions of applicable U.S. and non-U.S. securities laws (including, *e.g.*, pursuant to SEC Regulation S-K or Exchange Act Rule 10b-5).

[35] Among other things, two of the existing provisions (relating to securities acquisitions and conversions to prevent dilution and securities based on prior investment history) are being removed from the current subsection and are included instead as separate examples of items that are not deemed to be underwriting compensation. *See* Supplementary Material .01(b)(14), (16), (17) and (18).

[36] RN 20-10 at p. 12.

[37] *See* Rule 5110(d)(1) and (2).

[38] *See* RN 20-10 at p. 10.

[39] *See* Rule 5110(d)(3).

[40] *See* Rule 5110(d)(3)(A) and (B).

[41] *See* Rule 5110(d)(3)(C).

[42] *See* Rule 5110(d)(4).

[43] *See* RN 20-10 at p. 11.

[44] *See* Rule 5110(e)(2)(A)(vi).

[45] *See* Supplementary Material .02(a)-(c); *see also* RN 20-10 at p. 12.

[46] *See* RN 20-10 at p. 9.

[47] *See* Supplementary Material .03.

[48] *See* Supplementary Material .04.

[49] *See* Rule 5110(e)(2)(A)(iii).

[50] *See* Rule 5110(e)(2)(A)(iv).

[51] *See* Rule 5110(e)(2)(A)(v).

[52] *See* RN 20-10 at p. 15.

[53] *See* Rule 5110(e)(2)(A)(vi).

[54] *See* Rule 5110(e)(2)(A)(viii).

[55] *See* Rule 5110(e)(2)(A)(ix).

[56] *See* Rule 5110(e)(2)(B)(iii).

[57] *See* Rule 5110(e)(2)(B)(i).

[58] *See* Rule 5110(g)(4)(A).

[59] *See* Rule 5110(g)(4)(B).

[60] *See* Rule 5110(g)(7).

[61] *See* Rule 5110(j)(6).

[62] RN 20-10 at p. 16.

[63] *See* Rule 5110(j)(12).

[64] *See* Rule 5110(j)(15). The definition of “participate, participation or participating” in amended Rule 5110(j)(16) is functionally unchanged from the corresponding definition in the current rule; the definition of “affiliate” remains as defined in Rule 5121; and “associated person” is now defined by reference to Article I, Section (rr) of the FINRA By-Laws.

[65] *See* Rule 5110(j)(18).

[66] *See* Rule 5110(j)(20).