August 14, 2019

Ms. Vanessa Countryman
Acting Director
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Release No. 34-86509; File No. SR-FINRA-2019-012

Dear Ms. Countryman:

We are writing to comment on FINRA's proposed revisions ("the Proposal") to Rule 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) (the "Rule"), incorporated into FINRA's Form 19b-4 dated July 11, 2019. We are also writing to comment on FINRA's letter dated July 11, 2019 (the "Letter") in which FINRA responds to comments on FINRA's earlier proposed revisions to Rule 5110 published in the Federal Register on May 1, 2019.

One of the undersigned and another commenter recently described Rule 5110 as a "price-fixing rule"[1] and as a rule whose "fundamental purpose ... is to regulate prices,"[2] respectively. We proposed that FINRA consider the alternative of a disclosure rule.

In its July 11 letter, FINRA dismisses the disclosure alternative with the conclusory statement that "disclosure alone is not sufficient to prohibit unfair underwriting terms and arrangements that disadvantage issuers and investors ...." FINRA also refers in the letter to the SEC's approval of Rule 5110 in 1992 as "an acknowledgment that additional protections – beyond disclosure – are needed to govern underwriting terms and arrangements."

FINRA's appeal to events that took place in 1992 says much about FINRA's mindset. At the dawn of the Internet age, many unseasoned companies may have been unaware whether an underwriter's proposed terms and arrangements were "market," whether similarly-situated companies had agreed to them and what alternatives might be available.

In 2019, however, a few keystrokes in EDGAR can enable any company to identify the underwriting terms and conditions in hundreds of transactions and sort them by company, underwriter, type of security and type of underwriting arrangement. There are also vendors who will provide benchmark information on fees and expenses associated with a subset of transactions. Armed with such

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[1] W. Hardy Callcott letter dated May 30, 2017 to Jennifer Piorko Mitchell, FINRA, commenting on FINRA Regulatory Notice 17-15.

[2] Stuart J. Kaswell letter dated May 17, 2019 to Vanessa Countryman, SEC, commenting on Release No. 34-85715 (April 25, 2019).

information, a company can negotiate with a high degree of confidence that it can protect itself against over-reaching.

The improved ability of companies to negotiate fair and reasonable underwriting terms and arrangements suggests that disclosure may indeed be sufficient today to protect companies against rapacious underwriters even if this was not the case back in 1992. But FINRA's fixation on the past disables it from making an objective analysis of the degree to which companies still need its protection. The potentially diminished benefits of the rule also call into question whether these are sufficient to justify the rule's effect on competition and the costs and burdens that the rule imposes on market participants.

FINRA stated several years ago that while the 1934 Act did not set out requirements for SROs to conduct formal economic analyses of proposed rules, it had "historically taken into account the costs and burdens of its rulemaking" and that it was committed going forward to enhancing its economic impact assessments of its rules.[3] It also noted in the same statement that Section 15A(b)(9) of the 1934 Act requires the SEC to determine that the rule does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the 1934 Act.

But contrary to its intentions stated in 2013, FINRA has offered nothing in this Rule 5110 rulemaking in the way of facts to support an analysis of the benefits, costs and burdens of the rule or of the rule's effects on competition.

Competition. As noted above, Rule 5110 is on its face anti-competitive. FINRA dismisses this assertion on the basis that "[a]ll members [of FINRA] would be subject to the proposed amendments." This is a superficial response to a serious criticism. Underwriters compete not only among themselves to provide financing but also with banks and non-banks and with the private markets. To the extent that Rule 5110 forces companies to obtain financing from banks and non-banks or from the private markets, the competitive position of the latter is enhanced and that of underwriters is diminished. Capital formation is also harmed to the extent that companies are forced to obtain financing from outside the capital markets.

FINRA must provide the SEC with more than conclusory statements about Rule 5110's benefits to provide the SEC with a basis for the required Section 15A(b)(9) finding about competition. It could, for example, offer statistics on the frequency with which it objects to underwriting arrangements, how the frequency of its objections has increased or decreased over the last decade, the degree to which these objections are resolved in negotiations or in the withdrawal of a filing and how companies have fared after the withdrawal of a filing.

Costs and Burdens. Underwriters routinely pass on to companies the filing fees and legal expenses associated with complying with Rule 5110, which in effect imposes a tax on capital formation.

FINRA's filing fees are not even stated in Rule 5110 but are hidden in an obscure section of FINRA's by-laws. The basic fee is $500 plus .015% of the proposed maximum aggregate public offering price of an offering, with a cap of $225,000. FINRA does not identify the aggregate amount of fees it collects under Rule 5110 or make any attempt to justify its fees in terms of the rule's alleged benefits. On this basis

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[3] FINRA, Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking at 3 (September 2013).

alone, it is unclear how FINRA's Rule 5110 fees comply with the 1934 Act requirements that fees be reasonable and not impose an undue burden on competition.[3]

In addition to filing fees, however, Rule 5110 creates the need for companies and underwriters to consult on every transaction with a "small and highly-compensated coterie of experts ..., just to fill out FINRA's forms correctly and obtain prompt approval of the transaction ..., even for those for which there is no substantive concern about the compensation at issue."[4]

FINRA could easily calculate the aggregate amount of fees it has collected under the rule over the last ten years, and it could with little effort obtain from its members information on the amount of legal expenses that companies over that period have reimbursed to FINRA members for Rule 5110 advice.

If it does not provide the information referred to above, FINRA's 2013 assertions that it "has historically taken into account the costs and burdens of its rulemaking" and that it "is committed to enhancing its economic impact assessments of rules going forward" rings hollow indeed.

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Given companies' improved ability, as a result of information available from EDGAR and elsewhere, to negotiate underwriting terms and arrangements, and given the rule's adverse effects on competition and capital formation, the SEC should require FINRA to explain why Rule 5110 should not be replaced by a disclosure-only rule.

This letter represents the personal views of the undersigned and not necessarily the views of any clients or colleagues.

Very truly yours,

Joseph McLaughlin
[redacted]

W. Hardy Callcott
[redacted]

[3] *See* Division of Trading and Markets, Staff Guidance on SRO Rule Filing Relating to Fees (May 21, 2019) at 4-6.
[4] Callcott letter, supra note 1.