Law Office of Stuart J. Kaswell, LLC

August 16, 2019

Ms. Jill M. Peterson
Assistant Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File Number SR-FINRA-2019-012

Dear Ms. Peterson:

Thank you for the opportunity to comment on FINRA's further revisions[1] to its Rule 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) (''Rule'' or "Rule 5110"). I commend the Securities and Exchange Commission (''SEC'' or ''Commission'') for instituting proceedings to examine the Proposal in more detail.[2] I am especially pleased that the Release notes that "in particular, the Commission invites the written views of interested persons on whether the proposed rule change, as modified by Partial Amendment No. 1, is inconsistent with Section 15A(b)(6), or any other provision, of the Exchange Act, or the rules and regulations thereunder."[3]

[1] Release No. 34–86509; File No. SR–FINRA–2019–012, 84 FR 37921 (August 2, 2019) (the "Release" or the "Proposal").

[2] The Commission notes that:

> Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, nor does it mean that the Commission will ultimately disapprove the proposed rule change. Rather, as discussed below, the Commission seeks additional input on the proposed rule change, as modified by Partial Amendment No. 1, and on the issues presented by the proposal.

Release at 37921. The Release also states at 37931 that:

> The Commission is instituting proceedings to allow for additional analysis of the proposal's consistency with Section 15A(b)(9) of the Act,[153] which requires that FINRA's rules be designed to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Actually, this language is from Section 15A(b)(6) of the Exchange Act. The citation in the text must be a typographical error, since footnote 153 correctly cites to 15 U.S.C. 78o–3(b)(6).

[3] Release, at 37931.

I also commend FINRA for its willingness to make further changes to the proposal, even though those changes do not address my concerns.

Exchange Act Subsection 15A(b)(6).

In my earlier comment letter, I suggested that the Rule is not consistent with the Securities Exchange Act of 1934 ("Exchange Act") or the Securities Act of 1933 ("Securities Act") and enumerate my reasoning.[4] FINRA's response asserts that disclosure alone does not afford sufficient investor protection.[5] FINRA's response does not address the comments I made about Section 15A(b)(6) of the Exchange Act, which is the focus of the Commission's interest. As I previously, indicated, Congress specifically eliminated from the original Maloney Act[6] that provision granting authority to a registered national securities association to regulate "unreasonable profits or unreasonable rates of commissions or other charges…."[7] It is safe to assume that Congress was not in favor of unreasonable profits or commissions (nor am I). Instead and as part of Congress's broader efforts to deregulate commissions, it amended Section 15A(b)(6) of the Exchange Act to encourage price competition. Congress determined that robust competition was the most effective means for ensuring that investors received fair prices, not the rules of a registered national securities association.

The original Maloney Act also conditioned registration on the association having rules designed not to impose "to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other charges," language that Congress retained in the current version of this subsection.[8] Even if the Commission previously had concluded that the Rule passed muster under this standard, I submit that the Commission should reconsider its judgment. It is difficult to square a Rule whose purpose is to regulate prices with this provision. The myriad of changes in telecommunications, market structure, among other things, would justify the Commission's reconsideration of such an earlier conclusion.

As I have previously noted, Congress enacted the Securities Act with the assumption that investors, not a government agency, are the best judges of a new offering. Of course, Congress intended that the disclosure requirements of the Securities Act and the Commission's rules thereunder would ensure that public investors have material information upon which to make informed investment decisions. For example, Regulation S-K establishes disclosure requirements for the offering price, the market for the securities, risk factors, use of proceeds, and dilution of shareholders.[9] Indeed, Rule 508(e) requires the issuer to "provide a table that sets out the nature of the compensation and the amount of discounts and commissions to be paid to the underwriter for each security and in

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[4] Letter of Stuart J. Kaswell, Esq., May 17, 2019, available at https://www.sec.gov/comments/sr-finra-2019-012/srfinra2019012-5536598-185253.pdf. I incorporate by reference the comments that I made in my May 17 letter.
[5] Letter of Jeannette Wingler, Associate General Counsel, FINRA, July 11, 2019, at 2.
[6] Pub. L. No. 719 – 75th Cong., S. 3255, available at SEC Historical Society Website, http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1930/1938_0625_MaloneyAct.pdf
[7] Congress made this change in 1975 as part of the Securities Acts Amendments of the 1975 that deregulated commissions generally. My review of the US Code legislative history does not indicate that Congress made any additional changes in this provision in subsequent amendments.
[8] *Id.* The current language of 15A(b)(6) provides that the rules are designed not "to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members…."
[9] Regulation S-K, 17 CFR §229.501 *et seq*.

total."[10] Congress entrusted investors to decide if the issuer has a promising business model, sufficient expertise, a realistic opportunity to succeed over competitors, and a myriad of other issues.

Further, FINRA's focus on underwriter's compensation is misplaced. Underwriter's compensation is only one aspect of investors' decisions as to whether to commit their funds to an offering. Underwriter's compensation is one of least important economic factors that investors must consider. For example, an investor might be satisfied to pay an exorbitant underwriter's fee if he or she thought that the prospects of the issuer made such a fee worthwhile. However, under the Rule and the Proposal, public investors may never have the opportunity to consider purchasing such a security. Accordingly, I do not believe that FINRA's explanation of the rationale for the Proposal warrants the Commission's approval. Indeed, the Proposal calls into question the validity of the Rule as a whole.

Exchange Act Subsection 15A(b)(9)

I also believe that the Rule does not satisfy the requirements of Section 15A(b)(9) of the Exchange Act. That subsection provides that "the rules of the association do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title." FINRA's response does not address this statutory requirement.

In that regard, there is a less burdensome alternative to the Rule. Although it would be my preference to make underwriter's compensation just another disclosure matter, I wish to suggest a refinement of my proposal that may help address FINRA's concerns in a less intrusive and more transparent way. FINRA and the SEC could collect underwriters' compensation for the public offerings to which the Rule currently applies. FINRA could organize those data into different classifications of offerings and calculate average ranges of underwriters' compensation on a rolling basis within each classification. The Commission could amend Regulation S-K to require the issuer to disclose the amount of the underwriter's compensation and whether or not the amount of the underwriter's compensation was within the most recent range for that classification of offering.[11] Such an approach would empower investors by providing them with information about the underwriter's compensation and afford investors with a basis of comparison with respect to the amount of underwriters' compensation for similar deals. Underwriters and issuers would have more information about comparable transactions, thereby enhancing competition. As noted, FINRA keeps confidential its limitations on underwriters' compensation. Consistent with Congress's directive, this proposal would add new transparency and competition to that market place, as a substitute for FINRA's secretive review process.

Exchange Act Section 3(f)

Finally, the Commission cannot approve the Proposal consistent with Section 3(f) of the Exchange Act. For the reasons shown, the Proposal does not promote efficiency, competition, and capital

[10] 17 CFR §229.508(e). It further provides that "the table must show the separate amounts to be paid by the company and the selling shareholders. In addition, include in the table all other items considered by ….FINRA…to be underwriting compensation for purposes of FINRA rules."

[11] Under this formulation, the calculation of an underwriter's compensation might be simpler than the current Rule.

formation. A rule that forecloses issuers from accessing the public market does not further capital formation. A rule that keeps confidential the permissible amount of underwriters' compensation, rather than allowing investors to have information to judge such amount for themselves does not promote efficiency or competition. Opacity does not improve most markets.

Conclusion

It is not sufficient for FINRA to assert only that regulation of underwriters' compensation protects investors; it must show that its Proposal is consistent with the Exchange Act as Congress amended it. I do not believe that the Commission properly could conclude that the Proposal meets the statutory standards outlined above.

I respectfully suggest that FINRA should withdraw the Proposal and reconsider the Rule in its entirety. If FINRA disagrees with that suggestion, I urge the Commission to disapprove the Proposal. Finally, I suggest that should FINRA remain steadfast in its support of the Rule, that the Commission should consider instituting proceedings under Section 19(c) of the Exchange Act to delete the Rule in its entirety and that the Commission consider the proposal I made above.

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These views are my own and do not represent the view of any other person or entity. I would be pleased to discuss my suggestions with the Commission or the staff in greater detail.

Sincerely,

/s/
Stuart J. Kaswell

Copy: Robert Colby, CLO, FINRA