

## Conflicts of Interest

### SEC Approves Amendments to Modernize and Simplify NASD Rule 2720 Relating to Public Offerings in Which a Member Firm With a Conflict of Interest Participates

Effective Date: September 14, 2009

#### Executive Summary

Effective September 14, 2009, firms must comply with the requirements of new NASD Rule 2720 (Public Offerings of Securities with Conflicts of Interest), which governs public offerings of securities in which a member firm with a conflict of interest participates. The new rule amends and replaces the previous NASD Rule 2720 in its entirety.

As described more fully in this *Notice*, the rule prohibits a member firm with a conflict of interest from participating in a public offering, unless the nature of the conflict is prominently disclosed and:

- a qualified independent underwriter (QIU) participates in the offering; or
- the member firm(s) primarily responsible for managing the offering does not itself have a conflict (and is not an affiliate of a firm with a conflict); or
- the offered securities are exchange-listed and satisfy the requirements for a bona fide public market or are investment grade rated by a nationally recognized statistical rating organization.

Additionally, member firms with a conflict of interest must comply with certain net capital, discretionary accounts and filing requirements, as applicable.

The text of new NASD Rule 2720 is set forth in Attachment A of this *Notice*.

August 2009

#### Notice Type

- Rule Amendment

#### Suggested Routing

- Compliance
- Corporate Financing
- Legal
- Operations
- Senior Management

#### Key Topic(s)

- Affiliate
- Conflicts of Interest
- Control
- Investment Banking
- Public Offerings
- Qualified Independent Underwriter
- Underwriting Compensation

#### Referenced Rules & Notices

- FINRA Rule 5110
- FINRA Rule 9600 Series
- NASD Rule 2720
- NTM 06-52

Questions regarding this *Notice* should be directed to:

- ▶ Paul Mathews, Director, Corporate Financing Department, at (240) 386-4623;
- ▶ Lisa Toms, Associate Director and Senior Counsel, Corporate Financing Department, at (240) 386-4661;
- ▶ Gary Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; and
- ▶ Lisa Horrigan, Associate General Counsel, OGC, at (202) 728-8190.

## Background & Discussion

NASD Rule 2720 governs public offerings of securities issued by participating member firms or their affiliates, public offerings in which a member or any of its associated persons or affiliates has a conflict of interest, and public offerings that result in a FINRA member becoming a public company.

On June 15, 2009, the SEC approved amendments to Rule 2720 to modernize and simplify the rule.<sup>1</sup> New Rule 2720 prohibits a member firm with a “conflict of interest” from participating in a public offering unless certain requirements are met. The new rule also significantly revises the definition of “conflict of interest,” as described in more detail below.

When a member firm with a conflict of interest participates in a public offering, the new rule requires “prominent disclosure” in the prospectus, offering circular or similar document of the nature of the conflict of interest and, where a QIU is required, the name of the member firm acting as the QIU and a brief statement regarding the role and responsibilities of the QIU.<sup>2</sup> The prominent disclosure requirement applies to all offerings within the scope of new Rule 2720, whether or not a filing with FINRA is required.<sup>3</sup>

The new rule combines the previous rule’s tests of what constitutes an affiliate and conflict of interest into a single definition of “conflict of interest.”<sup>4</sup> As defined in Rule 2720(f)(5), a conflict of interest exists, if at the time of a member firm’s participation in a public offering, any of the following four conditions applies:

- ▶ The securities are to be issued by the member firm.
- ▶ The issuer controls, is controlled by or is under common control with the member firm or the member firm’s associated persons.<sup>5</sup>
- ▶ At least five percent of the net offering proceeds, not including underwriting compensation, are intended to be: (i) used to reduce or retire the balance of a loan or credit facility extended by the member firm, its affiliates and its associated persons, in the aggregate; or (ii) otherwise directed to the member firm, its affiliates and associated persons, in the aggregate.<sup>6</sup>

- If, as a result of the public offering and any transactions contemplated at the time of the public offering: (i) the member firm will be an affiliate of the issuer; (ii) the member firm will become publicly owned; or (iii) the issuer will become a member firm or form a broker-dealer subsidiary.

When a member firm with a conflict of interest participates in a public offering, a QIU may be required. If so, the QIU must participate in the preparation of the registration statement and the prospectus, offering circular or similar document (*i.e.*, the offering document) and exercise the usual standards of due diligence with respect to the offering document. The new rule eliminates the pricing responsibilities of the QIU. Any offering that requires a QIU must be filed with FINRA's Corporate Financing Department for review pursuant to FINRA Rule 5110 (Corporate Financing Rule).<sup>7</sup>

FINRA notes that while the term "participation in a public offering" in Rule 2720 generally has the same meaning as in FINRA Rule 5110,<sup>8</sup> the new rule continues to apply specifically to a member firm's participation in the distribution of a public offering as an underwriter, member of the underwriting syndicate or selling group, or otherwise assisting in the distribution of the public offering (*i.e.*, not when a member firm acts solely as a finder, consultant or advisor, given these capacities generally do not involve managing or distributing a public offering).

There are circumstances in which a member firm with a conflict of interest may participate in a public offering without the use of a QIU. Specifically, the new rule eliminates the need for a QIU if: (i) the member firm with a conflict of interest or an affiliate is not managing the offering; or (ii) the offered securities have a "bona fide public market" or are "investment grade rated" or are securities in the same series that have equal rights and obligations as investment grade rated securities (*e.g.*, securities issued under a medium-term note program). FINRA notes that the definition of "bona fide public market" in Rule 2720(f)(3) is changed substantially from the definition of "bona fide independent market," which it replaces, in that the new rule defines a bona fide public market in accordance with the numerical standards set forth in the SEC's Regulation M under the Exchange Act.<sup>9</sup>

In cases where two or more book-running lead managers have equal responsibilities with regard to due diligence, each must be free of conflicts of interest, otherwise the QIU provisions under the new rule would apply and the offering would be subject to the filing requirements under Rule 5110.

If a QIU is not required, the offering will not have to be filed with FINRA. Whether or not a filing is required, however, the new rule still requires prominent disclosure of the nature of the conflict in the offering documents. In addition, a member firm with a conflict of interest must comply with the discretionary accounts requirement, and where applicable the escrow, net capital computation and related disclosure provisions of the rule, as described below.

## Public Offering of a Member Firm: Escrow and Net Capital Computation

When a member firm participates in a public offering of its own securities, the new rule requires that all of the offering proceeds be placed in a duly established escrow account and not be released or used by the member firm in any manner until the member firm has complied with the net capital requirements set forth in the rule.<sup>10</sup> The new rule also requires any member firm offering its securities to disclose in the registration statement, offering circular or similar document a date by which the offering is reasonably expected to be completed and the terms upon which the proceeds will be released from the escrow account. These requirements are substantively similar to the provisions under previous Rule 2720.

## Discretionary Accounts

The new rule also requires a member firm that has a conflict of interest to comply with a prohibition on sales to discretionary accounts, unless the member firm has received specific written approval of the transaction from the account holder and retains documentation of the approval in its records.<sup>11</sup> These requirements only apply to the member firm with the conflict. FINRA notes, however, that they apply whether or not the offering must be filed and whether or not the securities are investment grade rated or have a bona fide public market. In addition, the “specific written approval” requirement can be satisfied by an email from the customer.

## Definitions

New Rule 2720 provides a set of definitions for purposes of the rule and incorporates, by reference, the definitions in FINRA Rule 5110. A number of definitions in the new rule are substantially similar to the definitions set forth in previous Rule 2720, while other terms in new Rule 2720 are newly defined, including “control,” “entity,” “investment grade rated” and “prominent disclosure.”

FINRA notes that the definition of “control” under Rule 2720(f)(6) includes beneficial ownership of ten percent or more of the outstanding common equity (which is defined to expressly include non-voting stock), subordinated debt or preferred equity of an “entity,” which is defined in Rule 2720(f)(7).<sup>12</sup> FINRA also notes that the exclusions in the term “entity” are substantially similar to the exemptions from the conflict of interest provisions contained in previous Rule 2720, with the exception of an entity that issues financing instrument-backed securities, which is now subject to the rule.

“Control” includes not only shares beneficially owned by a participating member firm, but also the right to receive such securities within 60 days of the member firm’s participation in the public offering. As a result, the determination of control is based on when the member firm participates in an offering, not the date that a registration statement for the offering is declared effective. For example, warrants or rights to acquire voting securities that are exercisable within 60 days of the member firm’s participation in the public offering would be included in the calculation of voting securities when determining whether control exists. The calculation to determine control, however, is limited to securities that could be received by the participating member firm only and would not include securities underlying warrants or rights held by other investors.<sup>13</sup>

FINRA also notes that the term “qualified independent underwriter” is defined in new Rule 2720(f)(12). The definition retains the provisions that require Section 11 liability undertakings and eligibility requirements relating to experience in managing offerings. The new rule extends to ten years the disqualification provisions regarding the disciplinary history of associated persons responsible for due diligence.

The new rule prohibits QIUs from receiving more than five percent of the offering proceeds. Receipt of such proceeds would disqualify a member firm from acting as a QIU because it would fall within the definition of “conflict of interest.” In addition, a QIU cannot beneficially own, as of the date of its participation in the public offering, more than five percent of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days.

Member firms are reminded that FINRA permits firms to provide information establishing that they meet the QIU qualification requirements in advance of participating in a particular public offering and that they may update this information annually. In the course of its review of information in connection with a public offering requiring a QIU, FINRA staff routinely asks for information that establishes that a member firm identified as a QIU is qualified to participate in that capacity. If a member firm has already provided this information within the last 12 months or has done an annual update, it will generally not need to provide the information in connection with that particular offering. In this regard, firms should consider updating the information that they previously provided in light of the changes to the QIU qualification requirements that are in the new rule.

## Requests for Exemption from NASD Rule 2720

Paragraph (e) provides that, pursuant to the FINRA Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member firm unconditionally or on specified terms from any or all of the provisions of Rule 2720 that it deems appropriate.

## Endnotes

- 1 See Exchange Act Release No. 60113 (June 15, 2009), 74 FR 29255 (June 19, 2009) (order approving SR-FINRA-2007-009). See also *Notice to Members (NTM) 06-52* (September 2006). The SEC also approved conforming changes to FINRA Rule 5110, including the transfer of certain definitions from Rule 2720 to FINRA Rule 5110.
- 2 See Rule 2720(a)(2)(B) regarding QIU disclosure requirements. “Prominent disclosure” is defined in Rule 2720(f)(10) and may include the notation “(Conflicts of Interest)” following the listing of the Plan of Distribution in the Table of Contents section and a disclosure in the Plan of Distribution section and any Prospectus Summary section as required in SEC Regulation S-K. For offering documents not subject to SEC Regulation S-K, prominent disclosure may be provided on the front page of the offering document stating that a conflict exists, with a cross-reference to the discussion within the offering document. These methods of disclosure are non-exclusive, and FINRA will consider alternative—but equally prominent—disclosures on a case-by-case basis.
- 3 With regard to a takedown from a shelf registration statement that became effective prior to September 14, 2009, the disclosure requirements in Rule 2720(a) could be included in, and would apply only to, a post effective amendment or prospectus supplement that is filed with the SEC on or after September 14, 2009.
- 4 A revised definition of “affiliate” under Rule 2720(f)(1) means an entity that controls, is controlled by or is under common control with a member firm.
- 5 The definition of “control” under Rule 2720(f)(6) includes beneficial ownership of ten percent or more of the outstanding common equity, subordinated debt or preferred equity of an “entity,” which is defined in Rule 2720(f)(7).
- 6 FINRA notes that the five-percent threshold applies to each participating member firm individually (including the member firm’s affiliates and its associated persons). Thus, for example, a conflict of interest would exist where a member firm receives five percent of the offering proceeds, but not where two unaffiliated member firms each receive three percent of the proceeds.
- 7 See NASD Rule 2720(d). FINRA Rule 5110 generally requires member firms to file with FINRA public offerings for review of the proposed underwriting terms and arrangements and requires disclosure of underwriting compensation and that a member firm obtains a “no objections” opinion prior to participating in the offering. FINRA Rule 5110(b)(7) contains certain exemptions from the filing requirements for, among others, public offerings of the securities of seasoned issuers and offerings of investment grade debt, but such offerings must be filed if subject to the filing requirement under Rule 2720.
- 8 See FINRA Rule 5110(a)(5).

## Endnotes continued

- 9 Specifically, “bona fide public market” is defined as a market for a security issued by a company that has been reporting under the Exchange Act for at least 90 days, is current in its reporting requirements and whose securities are traded on a national securities exchange with an average daily trading volume of at least \$1 million, provided that the issuer’s common equity securities have a public float value of at least \$150 million.
- 10 The rule also requires any member firm offering its securities to immediately notify FINRA when the public offering has been terminated and file with FINRA a computation of its net capital computed pursuant to the provisions of SEC Rule 15c3-1 (the net capital rule) as of the settlement date. Member firms are also reminded that additional escrow account maintenance and payment requirements may be applicable under SEC Rule 15c2-4 for “best efforts” offerings.
- 11 This prohibition is independent of any provisions in NASD Rule 2510.
- 12 For purposes of the rule, the percentage of control may be calculated using a “flow through” concept by looking through ownership levels to calculate the total percentage of control.
- 13 FINRA clarified in Amendment No. 1 to its rule filing (SR-FINRA-2007-009) that in calculating the percentage of beneficial ownership, it is appropriate to include the securities to be received by the participating member firm in both the numerator and denominator, but that this calculation should not include securities that could be received by all other investors. See Exchange Act Release No. 60113 (June 15, 2009), 74 FR 29255 (June 19, 2009) (order approving SR-FINRA-2007-009).

## ATTACHMENT A

Below is the text of the amendments. New language is underlined; deletions are in brackets.

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### 5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

### 5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

#### 5110. Corporate Financing Rule – Underwriting Terms and Arrangements

##### (a) Definitions

For purposes of this Rule, the following terms shall have the meanings stated below. The definitions in NASD Rule 2720 are incorporated herein by reference.

(1) through (10) No Change.

##### (11) Company

A corporation, a partnership, an association, a joint stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such.

##### (12) Effective Date

The date on which an issue of securities first becomes legally eligible for distribution to the public.

##### (13) Immediate Family

The parents, mother-in-law, father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or associated person of a member. In addition, the immediate family includes any other person who either lives in the same household as, provides material support to, or receives material support from, an employee or associated person of a member.



**(14) Person**

Any natural person, partnership, corporation, association, or other legal entity.

**(b) Filing Requirements**

(1) through (6) No Change.

**(7) Offerings Exempt from Filing**

Notwithstanding the provisions of subparagraph (1) above, documents and information related to the following public offerings need not be filed with FINRA for review, unless subject to the provisions of NASD Rule 2720(a)(2). However, it shall be deemed a violation of this Rule or NASD Rule 2810, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or NASD Rule 2810, as applicable:

(A) through (G) No Change.

(8) through (9) No Change.

(c) through (g) No Change.

**[(h) Proceeds Directed to a Member]****[(1) Compliance With NASD Rule 2720]**

[No member shall participate in a public offering of an issuer's securities where more than 10% of the net offering proceeds, not including underwriting compensation, are intended to be paid to participating members, unless the price at which an equity issue or the yield at which a debt issue is to be distributed to the public is established pursuant to NASD Rule 2720(c)(3).]

**[(2) Disclosure]**

[All offerings included within the scope of paragraph (h)(1) shall disclose in the underwriting or plan of distribution section of the registration statement, offering circular or other similar document that the offering is being made pursuant to the provisions of this subparagraph and, where applicable, the name of the member acting as qualified independent underwriter, and that such member is assuming the responsibilities of acting as a qualified independent underwriter in pricing the offering and conducting due diligence.]

**[(3) Exception From Compliance]**

[The provisions of paragraphs (h)(1) and (2) shall not apply to:]

[(A) an offering otherwise subject to the provisions of NASD Rule 2720;]

[(B) an offering of securities exempt from registration with the SEC under Section 3(a)(4) of the Securities Act;]

[(C) an offering of a real estate investment trust as defined in Section 856 of the Internal Revenue Code; or]

[(D) an offering of securities subject to NASD Rule 2810, unless the net offering proceeds are intended to be paid to the above persons for the purpose of repaying loans, advances or other types of financing utilized to acquire an interest in a pre-existing company.]

(i) through (j) redesignated as (h) through (i).

\* \* \* \* \*

**NASD Rule 2720 is replaced in its entirety by the following new rule language.**

**2720. Public Offerings of Securities With Conflicts of Interest****(a) Requirements for Participation in Certain Public Offerings**

No member that has a conflict of interest may participate in a public offering unless the offering complies with subparagraphs (1) or (2).

(1) There must be prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document for the public offering, and one of the following conditions must be met:

(A) the member(s) primarily responsible for managing the public offering does not have a conflict of interest, is not an affiliate of any member that does have a conflict of interest, and meets the requirement of paragraph (f)(12)(E);

(B) the securities offered have a bona fide public market; or

(C) the securities offered are investment grade rated or are securities in the same series that have equal rights and obligations as investment grade rated securities.

(2) (A) A qualified independent underwriter has participated in the preparation of the registration statement and the prospectus, offering circular, or similar document and has exercised the usual standards of “due diligence” in respect thereto; and

(B) there must be prominent disclosure in the prospectus, offering circular or similar document for the offering of:

(i) the nature of the conflict of interest;

(ii) the name of the member acting as qualified independent underwriter; and

(iii) a brief statement regarding the role and responsibilities of the qualified independent underwriter.

**(b) Escrow of Proceeds; Net Capital Computation**

(1) All proceeds from a public offering by a member of its securities shall be placed in a duly established escrow account and shall not be released therefrom or used by the member in any manner until the member has complied with subparagraph (2) hereof.

(2) Any member offering its securities pursuant to this Rule shall immediately notify FINRA when the public offering has been terminated and settlement effected and shall file with FINRA a computation of its net capital computed pursuant to the provisions of SEC Rule 15c3-1 under the Act (the net capital rule) as of the settlement date. If at such time its net capital ratio as so computed is more than 10:1 or, net capital fails to equal 120 percent of the minimum dollar amount required by Rule 15c3-1 or, in the event the member calculates its net capital requirement using the alternative standard (set forth in Rule 15c3-1(a)(1)(ii)), its net capital is less than seven percent of aggregate debit items as computed in accordance with Rule 15c3-3a, all monies received from sales of securities of the public offering must be returned in full to the purchasers thereof and the offering withdrawn, unless the member has obtained from the Commission a specific exemption from the net capital rule. Proceeds from the sales of securities in the public offering may be taken into consideration in computing net capital ratio for purposes of this paragraph.

(3) Any member offering its securities pursuant to this Rule shall disclose in the registration statement, offering circular or similar document a date by which the offering is reasonably expected to be completed and the terms upon which the proceeds will be released from the escrow account described in paragraph (b)(1).

**(c) Discretionary Accounts**

Notwithstanding Rule 2510, no member that has a conflict of interest may sell to a discretionary account any security with respect to which the conflict exists, unless the member has received specific written approval of the transaction from the account holder and retains documentation of the approval in its records.

**(d) Application of Rule 5110**

Any public offering subject to paragraph (a)(2) is subject to Rule 5110, whether or not the offering would be otherwise exempted from the filing or other requirements of that rule.

**(e) Requests for Exemption from Rule 2720**

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this rule that it deems appropriate.

**(f) Definitions**

The definitions in Rule 5110 are incorporated herein by reference. For purposes of this Rule, the following words shall have the stated meanings:

**(1) Affiliate**

The term “affiliate” means an entity that controls, is controlled by or is under common control with a member.

**(2) Beneficial Ownership**

The term “beneficial ownership” means the right to the economic benefits of a security.

### **(3) Bona Fide Public Market**

The term “bona fide public market” means a market for a security of an issuer that has been reporting under the Act for at least 90 days and is current in its reporting requirements, and whose securities are traded on a national securities exchange with an Average Daily Trading Volume (as provided by Regulation M under the Act) of at least \$1 million, provided that the issuer’s common equity securities have a public float value of at least \$150 million.

### **(4) Common Equity**

The term “common equity” means the total number of shares of common stock outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

### **(5) Conflict of Interest**

The term “conflict of interest” means, if at the time of a member’s participation in an entity’s public offering, any of the following applies:

(A) the securities are to be issued by the member;

(B) the issuer controls, is controlled by or is under common control with the member or the member’s associated persons;

(C) at least five percent of the net offering proceeds, not including underwriting compensation, are intended to be:

(i) used to reduce or retire the balance of a loan or credit facility extended by the member, its affiliates and its associated persons, in the aggregate; or

(ii) otherwise directed to the member, its affiliates and associated persons, in the aggregate; or

(D) as a result of the public offering and any transactions contemplated at the time of the public offering:

(i) the member will be an affiliate of the issuer;

(ii) the member will become publicly owned; or

(iii) the issuer will become a member or form a broker-dealer subsidiary.

**(6) Control**

(A) The term “control” means:

(i) beneficial ownership of 10 percent or more of the outstanding common equity of an entity, including any right to receive such securities within 60 days of the member’s participation in the public offering;

(ii) the right to 10 percent or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member’s participation in the public offering;

(iii) beneficial ownership of 10 percent or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member’s participation in the public offering;

(iv) beneficial ownership of 10 percent or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member’s participation in the public offering;  
or

(v) the power to direct or cause the direction of the management or policies of an entity.

(B) The term “common control” means the same natural person or entity controls two or more entities.

**(7) Entity**

For purposes of the definitions of affiliate, conflict of interest and control under this Rule, the term “entity”:

(A) includes a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons; and

(B) excludes the following:

(i) an investment company registered under the Investment Company Act of 1940;

(ii) a “separate account” as defined in Section 2(a)(37) of the Investment Company Act of 1940;

(iii) a “real estate investment trust” as defined in Section 856 of the Internal Revenue Code; or

(iv) a “direct participation program” as defined in Rule 2810.

**(8) Investment Grade Rated**

The term “investment grade rated” refers to securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

**(9) Preferred Equity**

The term “preferred equity” means the aggregate capital invested by all persons in the preferred securities outstanding without regard to class, whether voting or non-voting, convertible or non-convertible, exchangeable or non-exchangeable, redeemable or non-redeemable, as reflected on the consolidated financial statements of the company.

**(10) Prominent Disclosure**

A member may make “prominent disclosure” for purposes of paragraphs (a)(1) and (a)(2)(B) by:

(A) providing the notation “(Conflicts of Interest)” following the listing of the Plan of Distribution in the Table of Contents section required in Item 502 of SEC Regulation S-K, and by providing such disclosures in the Plan of Distribution section required in Item 508 and any Prospectus Summary section required in Item 503 of SEC Regulation S-K; or

(B) for an offering document not subject to SEC Regulation S-K, by providing disclosure on the front page of the offering document that a conflict exists, with a cross-reference to the discussion within the offering document and in the summary of the offering document if one is included.

**(11) Public Offering**

The term “public offering” means any primary or secondary offering of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition and all other securities offerings of any kind whatsoever, except any offering made pursuant to:

(A) an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act of 1933;

(B) SEC Rule 504, if the securities are “restricted securities” under SEC Rule 144(a)(3), SEC Rules 505 or 506; or

(C) SEC Rule 144A or Regulation S.

The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Act.

### **(12) Qualified Independent Underwriter**

The term “qualified independent underwriter” means a member:

(A) that does not have a conflict of interest and is not an affiliate of any member that has a conflict of interest;

(B) that does not beneficially own as of the date of the member’s participation in the public offering, more than 5% of the class of securities that would give rise to a conflict of interest, including any right to receive any such securities exercisable within 60 days;

(C) that has agreed in acting as a qualified independent underwriter to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in Section 11 thereof; and

(D) that has served as underwriter in at least three public offerings of a similar size and type during the three-year period immediately preceding the filing of the registration statement or the date of first sale in an offering without a registration statement. This requirement will be deemed satisfied if, during the past three years, the member:

(i) with respect to a proposed public offering of debt securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of debt securities each with gross proceeds of not less than 25% of the anticipated gross proceeds of the proposed offering; and

(ii) with respect to a proposed public offering of equity securities, has acted as sole underwriter or book-running lead or co-manager of at least three public offerings of equity securities (or of securities convertible into equity securities), each with gross proceeds of not less than 50% of the anticipated gross proceeds of the proposed offering.



(E) none of whose associated persons in a supervisory capacity who are responsible for organizing, structuring or performing due diligence with respect to corporate public offerings of securities:

(i) has been convicted within ten years prior to the filing of the registration statement or the preparation of an offering circular in an offering without a registration statement of a violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder, in connection with a registered or unregistered offering of securities;

(ii) is subject to any order, judgment, or decree of any court of competent jurisdiction entered within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules or regulations promulgated thereunder in connection with a registered or unregistered offering of securities; or

(iii) has been suspended or barred from association with any member by an order or decision of the Commission, any state, FINRA or any other self-regulatory organization within ten years prior to the filing of the registration statement, or the preparation of an offering circular in an offering without a registration statement, for any conduct or practice in violation of the anti-fraud provisions of the federal or state securities laws, or any rules, or regulations promulgated thereunder, or the anti-fraud rules of any self-regulatory organization in connection with a registered or unregistered offering of securities.

### **(13) Registration Statement**

The term “registration statement” means a registration statement as defined by Section 2(a)(8) of the Securities Act of 1933; notification on Form 1A filed with the Commission pursuant to the provisions of SEC Rule 252 under the Securities Act of 1933; or any other document, by whatever name known, initiating a registration or similar process for an issue of securities which is required to be filed by the laws or regulations of any federal or state agency.

**(14) Subordinated Debt**

The term “subordinated debt” includes (A) debt of an issuer which is expressly subordinate in right of payment to, or with a claim on assets subordinate to, any existing or future debt of such issuer; or (B) all debt that is specified as subordinated at the time of issuance. Subordinated debt shall not include short-term debt with maturity at issuance of less than one year and secured debt and bank debt not specified as subordinated debt at the time of issuance.

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