August 29, 2019

Via Electronic Filing

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: FINRA Proposed Rule Change to Amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions), SEC Rel. No. 34-86558, File No. SR-FINRA-2019-022

Dear Ms. Countryman:

The Investment Adviser Association[1] appreciates the opportunity to comment on the Financial Industry Regulatory Authority, Inc. ("FINRA") proposal to amend Rules 5130 and 5131 regulating the purchase and sale of initial public offerings, including amending the definition of investors who are prohibited from investing in new issues, *i.e.*, "restricted persons."[2] Our members are SEC-registered investment advisers that manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including U.S. and foreign pension plans, U.S. mutual funds, non-U.S. investment companies, trusts, private funds, endowments, foundations, and corporations. We appreciate and support FINRA's proposal to increase the opportunity for additional investors to invest in initial public offerings. However, we recommend certain improvements to the proposed exemptions from Rule 5130 for foreign employee retirement benefits plans ("Foreign Plans") and foreign investment companies.

Background

FINRA Rule 5130 is designed to protect the integrity of the public offering process by ensuring that broker-dealers make bona fide public offerings of securities at the offering price, that they do not withhold securities in a public offering for their own benefit or use those securities to reward persons who are in a position to direct future business to them, and that industry insiders do not take advantage of their insider position to purchase new issues for their own benefit at the

[1] The IAA is a not-for-profit association dedicated to advancing the interests of SEC-registered investment advisers. For more information, please visit our website: www.investmentadviser.org.

[2] *See* Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 5130 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings) and FINRA Rule 5131 (New Issue Allocations and Distributions); SEC Rel. 34-86558; File No. SR-FINRA 2019-022) (Aug. 2, 2019), 84 Fed. Reg. 39029 (Aug. 8, 2019) ("Proposal"), available at https://www.govinfo.gov/content/pkg/FR-2019-08-08/pdf/2019-16942.pdf. This letter focuses only on the proposed amendments to Rule 5130.

expense of public customers.[3] Compliance with Rule 5130 raises significant practical and operational challenges for our global asset managers that, as fiduciaries, seek opportunities to invest their clients' assets in the global capital markets. Because of these challenges, many of our members' clients may not currently meet the foreign investment company exemption from the investment prohibition because of their use of certain types of intermediaries and/or omnibus accounts. Our members are also restricted in their ability to invest in new issues on behalf of Foreign Plans clients whose assets they manage because Rule 5130 does not currently include an exemption for Foreign Plans. Therefore, we commend FINRA for its efforts to "remove certain impediments to capital formation without impacting investor protection,"[4] thereby increasing the availability of new issues for these types of clients. We believe that certain conditions in the proposed amended exemptions are too narrow to be useful, however, and recommend that they be modified to remove the proposed quantitative thresholds, as discussed below.

Recommendations

1. Remove the Quantitative Thresholds in the Proposed Exemption for Foreign Plans

Employee benefits plans under ERISA are currently exempt from the Rule 5130 prohibitions.[5] There is no similar exemption for Foreign Plans. FINRA recognizes that Foreign Plans "may find it impossible to assess whether they may permissibly invest in new issues," and has "previously acknowledged that . . . an exemption [from Rule 5130] may be appropriate" for these plans.[6] We appreciate that FINRA has proposed including an exemption in the rule for Foreign Plans – proposed Rule 5130(c)(8) – but suggest that one element of this exemption – that a Foreign Plan have at least 10,000 plan participants and beneficiaries and $10 billion in assets – is so prescriptive that it will be of limited use.[7] We request that this condition be eliminated.

[3] Proposal at 39029.

[4] *Id.* at 39030. In the past, FINRA has provided relief under Rule 5131(h) to exempt certain categories of persons from the rule to the extent that FINRA has found the exemption is consistent with the purposes of the rule. *See, e.g.,* Letter from Meredith Cordisco, FINRA, to Amy Natterson Kroll, Morgan, Lewis & Bockius LLP, re: Request for Exemption from FINRA Rule 5130 (July 25, 2015).

[5] Rule 5130(c)(7).

[6] Proposal at 39032.

[7] Proposed new Rule 5130(c)(8) would provide an exemption for purposes of the definition of restricted person for an employee retirement benefits plan organized under and governed by the laws of a foreign jurisdiction, provided that the plan or family of plans (i) has, in aggregate, at least 10,000 plan participants and beneficiaries and $10 billion in assets; (ii) is operated in a non-discriminatory manner insofar as a wide range of employees, regardless of income or position, are eligible to participate without further amendment or action by the plan sponsor; (iii) is administered by trustees or managers that have a fiduciary obligation to administer the funds in the best interests of the participants and beneficiaries; and (iv) is not sponsored solely a broker-dealer.

Our members manage assets on behalf of Foreign Plan clients that meet all the other conditions, but may have fewer than 10,000 plan participants or less than $10 billion in assets. We understand from our members that this arbitrary condition would leave many bona fide Foreign Plans unable to invest in new issues. We do not see how it would serve the policies or goals underlying the rule to prohibit Foreign Plan clients with, for example, 9,900 participants and beneficiaries or $9.9 billion in assets from participating in a new issue while permitting Foreign Plan clients with marginally more participants, beneficiaries, or assets to participate.

Further, we do not believe a quantitative limit is necessary to demonstrate that the Foreign Plan does not have a concentration of interest, especially when certain bona fide Foreign Plans tend to be organized on a much smaller scale than similar U.S. plans (*e.g.*, Foreign Plans that are organized in emerging markets, Australian superannuation funds, and others).[8]

Instead, we believe the three other proposed conditions – (i) that the Foreign Plan is non-discriminatory and available by default to a wide range of employees; (ii) that it is administered by a fiduciary; and (iii) that it is not sponsored solely a broker-dealer – are sufficiently robust to satisfy the objectives of the rule to prevent abuse.

Accordingly, we recommend that Rule 5130(c)(8)(A) be eliminated to remove the minimum number of beneficiaries and plan assets to be consistent with the ERISA plan exemption in Rule 5130(c)(7) and to permit bona fide foreign plan investors to invest in new issues.

2. Remove the Quantitative Thresholds from the Foreign Public Investment Companies Exemption and Proposed Amendments

FINRA also proposes to add new alternative conditions upon which foreign investment companies may rely in order to be exempt from the Rule 5130 prohibition. Rule 5130(c)(6) will continue to require that the investment company be listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority. The rule will also continue to require that no person owning more than five percent of the shares of the foreign investment company be a restricted person. The Proposal adds two additional conditions that could be relied on as alternatives to the five percent test: (i) that the foreign investment company has 100 or more direct owners; or (ii) that the foreign investment company has 1,000 or more indirect owners. Indirect ownership includes ownership through layers of intermediaries, with

[8] We note that the federal financial regulators (the "Volcker Agencies") have defined "foreign pension or retirement fund" for purposes of exclusion from the Volcker Rule's prohibition on investments in or sponsorship of "covered funds" without reference to a threshold of investors or assets. *See* 12 CFR Section 248.10 (defining "foreign pension or retirement fund" as a plan, fund, or program providing pension, retirement, or similar benefit that is: (i) organized and administered outside the United State, (ii) a broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and (iii) established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof).

legal ownership held by nominees. FINRA believes that satisfying any of these three conditions would address concerns about concentration of ownership of the fund.[9]

We appreciate that FINRA recognizes that it is operationally impractical for a foreign investment company to determine whether an investor owns more than five percent of its shares when investors acquire and hold their interests indirectly.[10] FINRA's proposal to add two additional quantitative tests is thus designed to provide foreign investment companies with alternative ways of demonstrating that they are widely held. We do not believe that any of these quantitative tests is necessary to achieve FINRA's goals, however, and urge FINRA to eliminate all three of these tests.

Rule 5130 exempts U.S. registered investment companies without requiring those entities to meet any quantitative thresholds. Quantitative tests are not deemed necessary to ensure that a U.S. registered investment company is widely held, and they should similarly not be necessary to demonstrate that a foreign public fund that meets the other conditions of the exemption is widely held. Foreign public investment companies, such as UCITS funds whose organization and manner of offer or sale is highly regulated in their home jurisdictions, should not be disqualified from being able to rely on the exemption simply because the applicable regulatory regime permits them to have fewer investors or assets than the thresholds proposed by FINRA.

The Volcker Rule regulations are instructive here as well. They define "foreign public fund" to capture non-U.S. funds that are similar to U.S. registered investment companies. Notably, they do not incorporate any quantitative tests to demonstrate the public nature of the fund,[11] reflecting a view that such tests are not necessary to ensure that a foreign public fund is widely held.

The elimination of the quantitative tests should not undermine the effectiveness of the two conditions that would remain, namely that the fund is listed or authorized for sale to the public and that it is not formed for the specific purpose of investing in new issues. We believe that, taken together, these two conditions should achieve the goal of preventing improper treatment of and access to initial public offerings.

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[9] Proposal at 39033.

[10] *Id.* at 39032.

[11] *See* 12 CFR Section 248.10 (defining "foreign public funds" as an issuer that (i) is organized or established outside of the United States; (ii) is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and (iii) sells ownership interests predominately through one or more public offerings outside of the United States. The rule defines "public offering" as a distribution of securities in any jurisdiction outside the United States to investors, including retail investors, provided that (i) the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; (ii) the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and (iii) the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.) While the Volcker Agencies have indicated that they plan to propose changes to the Volcker Rule regulations that address fund restrictions, we do not expect those agencies to introduce quantitative tests into these definitions.

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For the reasons discussed above, we respectfully request that proposed Rule 5130 be modified so that it effectively removes unnecessary impediments to capital formation and lessens burdens in the public offering process by harmonizing the exemptions for Foreign Plans and foreign public investment companies with those available to U.S. pension plans and registered investment companies. We appreciate your consideration of our comments on this important proposal. Please feel free contact me or Monique Botkin, IAA Associate General Counsel, at (202) 293-4222 with any questions or if you would like additional information.

Respectfully,

/s/

Gail C. Bernstein
General Counsel

cc: The Honorable Jay Clayton, Chairman
The Honorable Hester Peirce, Commissioner
The Honorable Elad Roisman, Commissioner
The Honorable Robert Jackson, Commissioner
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William Hinman, Director, Division of Corporation Finance
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