

Initial Public Offering (IPO) Rules

SEC Approves Amendments to FINRA Rules 5130 and 5131 Relating to Equity IPOs

Effective Date: January 1, 2020

Summary

The Securities and Exchange Commission (SEC) approved a 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) to modify the rules to enhance regulatory consistency and address unintended operational impediments.¹ These changes become effective on January 1, 2020.

The text of the amended rules is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

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- ▶ Meredith Cordisco, Associate General Counsel, OGC, at (202) 728-8018.

Background and Discussion

Rule 5130 protects the integrity of the public offering process by ensuring that: (1) member firms make bona fide public offerings of securities at the offering price; (2) member firms do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to member firms; and (3) industry insiders, including member firms and their associated persons, do not take advantage of their insider position to purchase new issues for their own benefit at the expense of public customers.² Paragraph (a) of Rule 5130 provides that, except as otherwise permitted under the rule: (1) a member firm (or an associated person) may not sell a new issue to an account in which a restricted person has a beneficial interest; (2) a member firm (or an associated person) may not purchase a new issue in any account in which such member firm or associated person has a beneficial interest; and (3) a member firm may not continue to hold new issues acquired as an underwriter, selling group member or otherwise.³

December 19, 2019

Notice Type

- ▶ Rule Amendment

Suggested Routing

- ▶ Compliance
- ▶ Corporate Financing
- ▶ Legal
- ▶ Operations
- ▶ Senior Management
- ▶ Syndicate
- ▶ Underwriting

Key Topics

- ▶ Anti-Dilution Provisions
- ▶ Charitable Organizations
- ▶ Employee Retirement Benefits Plans
- ▶ Family Investment Vehicles and Family Offices
- ▶ Foreign Investment Companies
- ▶ Foreign Offerings
- ▶ Issuer-Directed Allocations
- ▶ Lock-Up Agreements
- ▶ Sovereign Entities
- ▶ Special Purpose Acquisition Companies

Referenced Rules & Notices

- ▶ Advisers Act Rule 202(a)(11)(G)-1
- ▶ Exchange Act Section 3(a)(11)
- ▶ FINRA Rules 5130 and 5131
- ▶ IRC Sections 401(a) and 501(c)(3)
- ▶ Regulatory Notice 10-60
- ▶ Securities Act Regulation S

Rule 5131 addresses abuses in the allocation and distribution of new issues.⁴ The rule prohibits a member firm from offering or threatening to withhold shares it allocates in a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the firm.⁵ The rule also prohibits a member firm from recouping, or attempting to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate. In addition, the rule prohibits the practice of “spinning,”⁶ which is the allocation of new issues by a member firm to an account in which an executive officer or a director of a public company or covered non-public company that is the member firm’s current, former or prospective investment banking client has a beneficial interest.⁷ Finally, the rule sets forth requirements relating to IPO practices, including with respect to lock-up agreements.

Based upon FINRA’s experience applying these rules since their adoption and input from industry participants regarding practical and operational issues relating to the rules, FINRA has made the following substantive changes:

- ▶ provided alternative conditions for satisfying the foreign investment company exemption;
- ▶ exempted U.S. and foreign employee retirement benefits plans that meet specified conditions;
- ▶ aligned and clarified the provisions relating to issuer-directed allocations;
- ▶ excluded foreign offerings, independent allocations to non-U.S. persons by foreign non-member broker-dealers participating in underwriting syndicates and offerings of special purpose acquisition companies (SPACs);
- ▶ expanded the definition of “family investment vehicle” under Rule 5130 to include legal entities that are beneficially owned by “family members” and “family clients” as defined under the Investment Advisers Act of 1940 (Advisers Act);
- ▶ excluded sovereign entities that own broker-dealers from the categories of restricted persons under Rule 5130;
- ▶ excluded certain transfers to immediate family members from Rule 5131’s public announcement requirement relating to lock-up agreements and codified existing guidance regarding the disclosure of a lock-up agreement release or waiver in a publicly filed registration statement;
- ▶ excluded unaffiliated charitable organizations from the definition of “covered non-public company” in Rule 5131; and
- ▶ added an anti-dilution provision to Rule 5131, similar to the provision in Rule 5130.

FINRA believes that these amendments, which are discussed in greater detail below, will promote capital formation, aid member firm compliance efforts and maintain the integrity of the public offering process.

Foreign Investment Companies

Rule 5130(c)(6) and, by reference, Rule 5131(b)(2) currently provide a general exemption for an investment company organized under the laws of a foreign jurisdiction, provided that: (1) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; and (2) no person owning more than five percent of the shares of the investment company is a restricted person. A foreign public investment company may face operational difficulties in determining whether any particular investor owns more than five percent of its shares where the shares are held in an omnibus account or in nominee form. To address this issue, FINRA has amended the exemption to provide the following alternative conditions to the five percent condition: (1) the investment company has 100 or more direct investors; or (2) the investment company has 1,000 or more indirect investors. In conjunction with this change, FINRA has also added a new condition to the exemption to ensure that the investment company has not been formed for the specific purpose of permitting restricted persons to invest in new issues.

Employee Retirement Benefits Plans

In the past, FINRA staff has provided exemptive relief on a case-by-case basis to certain U.S. and foreign employee retirement benefits plans that did not qualify for one of the general exemptions under the rules.⁸ FINRA has codified this relief by adopting a general exemption for such benefits plans, subject to specified conditions. New Rule 5130(c)(8) and, by reference, Rule 5131(b)(2) provide an exemption for an employee retirement benefits plan organized under, and governed by, U.S. or foreign laws, provided that such plan or family of plans: (1) has, in aggregate, at least 10,000 plan participants and beneficiaries and \$10 billion in assets; (2) 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; (3) 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 (4) is not sponsored solely by a broker-dealer.

Issuer-Directed Securities

Rules 5130(d) and 5131.01 provide exemptions for issuer-directed allocations of securities, subject to specified conditions.⁹ Consistent with current Rule 5131.01, FINRA has amended paragraph (d) of Rule 5130 to apply the exemptions to securities directed by affiliates and selling shareholders of the issuer and to clarify that the exemptions apply to securities that are directed in writing. FINRA has clarified that the exemptions also apply to securities that are directed by a single affiliate or a single selling shareholder of the issuer. In addition, FINRA has amended Rule 5130(d)(1)(B) to permit issuer-directed allocations of securities to employees and directors of franchisees.

Foreign Offerings and Independent Allocations by Foreign Non-Member Broker-Dealers

The definition of “new issue” currently does not exclude foreign offerings, such as offerings made under Regulation S of the Securities Act of 1933 (Securities Act). To remove any potential and unintended impediments to the public offering process in foreign jurisdictions, FINRA has amended the definition, which has the same meaning in both Rule 5130 and Rule 5131, to exclude an offering made under Regulation S or otherwise made outside of the U.S. or its territories, provided that securities in the offering are not concurrently registered for sale in the United States. The amendment is consistent with similar exclusions in other FINRA rules relating to the public offering process.¹⁰ While a foreign offering that is concurrently registered for sale in the United States would not be categorically excluded from the definition of “new issue,” FINRA has adopted Rule 5130.01 and Rule 5131.05 to clarify that the rules do not prohibit allocations of new issues to non-U.S. persons by foreign non-member broker-dealers participating in the underwriting syndicate, provided that such allocation decisions are not made at the direction or request of a member firm or its associated persons.

SPACs

The definition of “new issue” currently excludes offerings of registered closed-end investment companies, business development companies, direct participation programs and real estate investment trusts. FINRA excluded offerings of these entities because their securities typically commence trading at the public offering price with little potential for trading at a premium given that their assets at the time the IPO trades consist of the capital they have raised through the offering process. Moreover, if there is a premium, it is generally small. FINRA has amended the definition of “new issue” to treat offerings of SPACs similarly, because they have similar trading characteristics to the offerings that are currently excluded from the definition.

Family Investment Vehicles

A person with the authority to buy or sell securities for a family investment vehicle is not considered a portfolio manager based solely on that investment authority and, therefore, is not a restricted person under Rule 5130. Currently, the term “family investment vehicle” is defined as a legal entity that is beneficially owned solely by immediate family members.¹¹ FINRA has aligned the definition of “family investment vehicle” with the definitions relating to family offices under the Advisers Act. Specifically, amended Rule 5130(i)(4) defines a “family investment vehicle” as a legal entity that is beneficially owned solely by one or more of the following persons: (1) “immediate family members” as defined under Rule 5130(i)(5); (2) “family members” as defined under Advisers Act Rule 202(a)(11)(G)-1; or (3) “family clients” as defined under Advisers Act Rule 202(a)(11)(G)-1. A family investment vehicle may include a legal entity that is beneficially owned by any combination of these persons.

Sovereign Entities

Currently, sovereign entities that acquire an ownership interest in a registered broker-dealer may become restricted persons under Rule 5130, which is not the intended purpose of the rule. To address this unintended impact, FINRA has amended Rule 5130(i)(10)(E) to exclude sovereign entities from the category of restricted persons covering owners of broker-dealers. A “sovereign entity” is defined as a sovereign nation or a pool of capital or an investment fund or other vehicle owned or controlled by a sovereign nation and created for the purpose of making investments on behalf, or for the benefit, of the sovereign nation.¹² Further, a “sovereign nation” is defined as a sovereign nation or its political subdivisions, agencies or instrumentalities.¹³ The exclusion for sovereign entities would not extend to affiliates of sovereign entities that are otherwise restricted persons. Therefore, while a sovereign entity that owns a broker-dealer would not be considered a restricted person under the amended rule, the broker-dealer itself would continue to be a restricted person.

Lock-Up Agreements

Rule 5131(d)(2) requires that any lock-up agreement applicable to the officers and directors of an issuer entered into in connection with a new issue stipulate that, at least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer’s shares, the book-running lead manager must notify the issuer of the impending release or waiver and the impending release or waiver must be announced through a major news service.¹⁴ The rule currently provides an exception from this requirement where the release or waiver is for a transfer that is not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor. FINRA has amended the rule to extend the exception to transfers to “immediate family members” as defined in Rule 5130(i)(5), provided that the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor. In addition, FINRA has amended Rule 5131.03 relating to lock-up announcements to provide that the disclosure of a release or waiver in a publicly filed registration statement in connection with a secondary offering satisfies the requirement for an announcement through a major news service, which is a codification of prior published guidance.¹⁵

Unaffiliated Charitable Organizations

The “spinning” prohibition under Rule 5131 currently applies to executive officers and directors of charitable organizations that are current, former or prospective investment banking clients of a member firm and that meet the definition of a “covered non-public company.”¹⁶ The inclusion of executive officers and directors of these charitable organizations was unintended. Charitable organizations are not likely to generate significant investment banking business relative to traditional investment banking clients

and, thus, there is a low risk, if any, that improper incentives would motivate a member firm's decision to allocate IPO shares to the account of executive officers or directors of such organizations. Accordingly, FINRA has amended Rule 5131(e)(3) to exclude "unaffiliated charitable organizations," as that term is elsewhere defined in the rule,¹⁷ from the definition of "covered non-public company." As a result of this amendment, an executive officer or a director of a charitable organization that is not affiliated with the member firm allocating IPO shares would not become the subject of the "spinning" prohibition solely on the basis of that service.

Anti-Dilution

Rule 5130 allows a restricted person that is an existing equity owner of an issuer to purchase shares of the issuer in a public offering in order to maintain the restricted person's equity ownership position, subject to the following conditions: (1) the restricted person has held an equity ownership interest in the issuer for a period of one year prior to the effective date of the offering; (2) the sale of the new issue does not increase the restricted person's percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement in connection with the offering; (3) the sale of the new issue to the restricted person does not include any special terms; and (4) the purchased shares are not sold, transferred, assigned, pledged or hypothecated for three months following the effective date of the offering.¹⁸ FINRA believes that executive officers and directors of public companies and covered non-public companies who are subject to Rule 5131's "spinning" prohibition should also be able to maintain the same equity ownership level that they held prior to a public offering. Therefore, FINRA has adopted similar anti-dilution provisions under Rule 5131 for such executive officers and directors.¹⁹

Endnotes

1. See Securities Exchange Act Release No. 87470 (November 5, 2019), 84 FR 61102 (November 12, 2019) (Order Granting Accelerated Approval of File No. SR-FINRA-2019-022).
2. “New issue” means any IPO of an equity security as defined in Section 3(a)(11) of the Securities Exchange Act of 1934 (Exchange Act), made pursuant to a registration statement or an offering circular, subject to some exceptions. See Rule 5130(i)(9).
3. The term “restricted person” includes the following categories of persons: (1) broker-dealers; (2) broker-dealer personnel; (3) finders and fiduciaries; (4) portfolio managers; and (5) persons owning a broker-dealer. See Rule 5130(i)(10). For purposes of Rule 5130, the term “broker-dealer” includes foreign broker-dealers that are operating based on an exemption under the Exchange Act. A portfolio manager is a person who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor or collective investment account. See Rule 5130(i)(10)(D). A person who has the title of portfolio manager but who does not otherwise have the authority to buy or sell securities is not considered a portfolio manager for purposes of Rule 5130. The term “beneficial interest” means any economic interest, such as the right to share in gains or losses. See Rule 5130(i)(1). The receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, is not considered a beneficial interest in the account. See *id.*
4. The term “new issue” has the same meaning as in Rule 5130(i)(9). See Rule 5131(e)(7).
5. FINRA will assess whether compensation is excessive under the rule based on all of the relevant facts and circumstances including, where applicable, the level of risk and effort involved in the transaction and the rates generally charged for the same or similar services.
6. See Rule 5131(b).
7. The term “beneficial interest” has the same meaning as in Rule 5130(i)(1). See Rule 5131(e)(2).
8. The rules currently provide a general exemption for an Employee Retirement Income Security Act benefits plan that is qualified under Section 401(a) of the Internal Revenue Code (IRC), provided that the plan is not sponsored solely by a broker-dealer. The current rules also provide a general exemption for a state or municipal government benefits plan that is subject to state or municipal regulation. See Rules 5130(c)(7) and (c)(8) and Rule 5131(b)(2).
9. Persons that are not eligible for issuer-directed allocations under the rules may still be eligible for a new issue allocation if they otherwise qualify for another exemption under the rules, including the *de minimis* exemptions under Rule 5130(c)(4) and Rule 5131(b)(2), as applicable.
10. See, e.g., Rule 5121 (Public Offerings of Securities With Conflicts of Interest).
11. See Rule 5130(i)(4). The term “immediate family member” is defined as a person’s parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support. See Rule 5130(i)(5).
12. See Rule 5130(i)(11).
13. See Rule 5130(i)(12).

14. The public announcement requirement under Rule 5131(d)(2) applies to a release or waiver of any lock-up or other restriction on the transfer of securities subject to a lock-up agreement that has been publicly disclosed. If the lock-up agreement has been publicly disclosed, any release or waiver of any lock-up or other restriction on the transfer of securities would be subject to the public announcement requirement, even if the offering is not yet effective. However, in such cases, the public announcement requirement may be satisfied through a public filing that otherwise meets the timing requirements of the rule. With respect to the timing of the public announcement, the announcement should be made two business days prior to the impending release or waiver that permits an officer or a director to transfer securities subject to the lock-up agreement. Further, the public announcement requirement applies to a release or waiver of any lock-up or other restriction on the transfer of securities, and not releases or waivers that relate to mechanical or technical provisions of the lock-up agreement.
15. See [Regulatory Notice 10-60](#) (November 2010).
16. The term “covered non-public company” means any non-public company satisfying the following criteria: (1) income of at least \$1 million in the last fiscal year or in two of the last three fiscal years and shareholders’ equity of at least \$15 million; (2) shareholders’ equity of at least \$30 million and a two-year operating history; or (3) total assets and total revenue of at least \$75 million in the latest fiscal year or in two of the last three fiscal years. See Rule 5131(e)(3).
17. An “unaffiliated charitable organization” is a tax-exempt entity organized under Section 501(c)(3) of the IRC that is not affiliated with the member firm and for which no executive officer or director of the member firm, or person materially supported by such executive officer or director, is an individual listed or required to be listed on Part VII of Internal Revenue Service Form 990 (*i.e.*, officers, directors, trustees, key employees, highest compensated employees and certain independent contractors). See Rule 5131(e)(9).
18. See Rule 5130(e). It would be appropriate to consider convertible securities, options and warrants for purposes of determining whether a person satisfies the one-year holding period and the three-month equity ownership calculation period under the rule, provided that the person had the ability to convert or exercise such securities during the course of the applicable period.
19. See Rule 5131.04.

Attachment A

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

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5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

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5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

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5130. Restrictions on the Purchase and Sale of Initial Equity Public Offerings

(a) through (b) No Change.

(c) General Exemptions

The general prohibitions in paragraph (a) of this Rule shall not apply to sales to and purchases by the following accounts or persons, whether directly or through accounts in which such persons have a beneficial interest:

(1) through (5) No Change.

(6) An investment company organized under the laws of a foreign jurisdiction, provided that:

(A) the investment company is listed on a foreign exchange for sale to the public or authorized for sale to the public by a foreign regulatory authority; [and]

(B) no person owning more than 5% of the shares of the investment company is a restricted person[;], the investment company has 100 or more direct investors, or the investment company has 1,000 or more indirect investors; and

(C) the investment company was not formed for the specific purpose of permitting restricted persons to invest in new issues;

(7) No Change.

(8) An employee retirement benefits plan organized under and governed by the laws of the United States or of a foreign jurisdiction, provided that such plan or family of plans:

(A) has, in aggregate, at least 10,000 plan participants and beneficiaries and \$10 billion in assets;

(B) 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;

(C) 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

(D) is not sponsored solely by a broker-dealer;

~~[(8)]~~(9) A state or municipal government benefits plan that is subject to state [and/]or municipal regulation;

~~[(9)]~~(10) A tax exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code; or

~~[(10)]~~(11) A church plan under Section 414(e) of the Internal Revenue Code.

(d) Issuer-Directed Securities

The prohibitions on the purchase and sale of new issues in this Rule shall not apply to securities that:

(1) are specifically directed in writing by the issuer, an affiliate of the issuer, or a selling shareholder, to persons that are restricted under the Rule; provided, however, that securities directed by an issuer, an affiliate of the issuer, or a selling shareholder, may not be sold to or purchased by:

(A) a broker-dealer; or

(B) an account in which any restricted person specified in paragraphs (i)(10)(B) or (i)(10)(C) of this Rule has a beneficial interest, unless such person, or a member of his or her immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent,

or of a franchisee of any of the foregoing entities. Also, for purposes of this paragraph (d)(1) only, a parent/subsidiary relationship is established if the parent has the right to vote 50% or more of a class of voting security of the subsidiary, or has the power to sell or direct 50% or more of a class of voting security of the subsidiary;

(2) are specifically directed in writing by the issuer, an affiliate of the issuer, or a selling shareholder, and are part of an offering in which no broker-dealer:

(A) underwrites any portion of the offering;

(B) solicits or sells any new issue securities in the offering; and

(C) has any involvement or influence, directly or indirectly, in the issuer's allocation decisions with respect to any of the new issue securities in the offering;

(3) No Change.

(4) are directed in writing to eligible purchasers who are otherwise restricted under the Rule as part of a conversion offering in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering.

(e) through (h) No Change.

(i) Definitions

(1) through (3) No Change.

(4) "Family investment vehicle" means a legal entity that is beneficially owned solely by one or more of the following persons:

(A) immediate family members[.];

(B) family members, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act; or

(C) family clients, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act.

(5) through (8) No Change.

(9) “New issue” means any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act, made pursuant to a registration statement or offering circular. New issue shall not include:

(A) offerings made pursuant to an exemption under Section 4(a)(1), 4(a)(2) or 4(a)(5)[(6)] of the Securities Act, or Securities Act Rule 504 if the securities are “restricted securities” under Securities Act Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder, or offerings made under Regulation S of the Securities Act or otherwise made outside of the United States or its territories unless the securities offered and sold in the Regulation S offering or other offering made outside of the United States are also registered for sale in the United States under the Securities Act in connection with a concurrent initial public offering of an equity security in the United States;

(B) through (I) No Change.

(J) offerings of a special purpose acquisition company subject to Securities and Exchange Commission rules and regulations, a business development company as defined in Section 2(a)(48) of the Investment Company Act, a direct participation program as defined in Rule 2310(a) or a real estate investment trust as defined in Section 856 of the Internal Revenue Code.

(10) “Restricted person” means:

(A) through (D) No Change.

(E) Persons Owning a Broker-Dealer

(i) through (ii) No Change.

[(iii) Any person listed, or required to be listed, in Schedule C of a Form BD that meets the criteria of subparagraphs (E)(i) and (E)(ii) above;]

[(iv)] iii Any person that directly or indirectly owns 10% or more of a public reporting company listed, or required to be listed, in Schedule A of a Form BD (other than a reporting company that is listed on a national securities exchange or other than with respect to a limited business broker-dealer);

[(v)] (iv) Any person that directly or indirectly owns 25% or more of a public reporting company listed, or required to be listed, in Schedule B of a Form BD (other than a reporting company that is listed on a national securities exchange or other than with respect to a limited business broker-dealer);

[(vi)] (v) An immediate family member of a person specified in subparagraphs (E)(i) through [(v)] (iv) unless the person owning the broker-dealer:

- a. does not materially support, or receive material support from, the immediate family member;
- b. is not an owner of the member, or an affiliate of the member, selling the new issue to the immediate family member; and
- c. has no ability to control the allocation of the new issue.

(vi) Subparagraphs (E)(i) through (iv) shall not apply to a sovereign entity.

(11) "Sovereign entity" means a sovereign nation or a pool of capital or an investment fund or other vehicle owned or controlled by a sovereign nation and created for the purpose of making investments on behalf or for the benefit of the sovereign nation.

(12) "Sovereign nation" means a sovereign nation or its political subdivisions, agencies or instrumentalities.

(j) No Change.

••• Supplementary Material: -----

.01 Application to Foreign Non-Member Broker-Dealers Participating in an Underwriting Syndicate. The prohibitions on the purchase and sale of new issues in this Rule shall not apply to a foreign non-member broker-dealer that is participating in an underwriting syndicate for the sale of a new issue (which underwriting syndicate may include a member affiliate of the non-member broker-dealer) and allocating new issue securities to a non-U.S. person, provided that such allocation decision is not made at the direction or request of a member or an associated person of a member.

5131. New Issue Allocations and Distributions

(a) No Change.

(b) Spinning

(1) No Change.

(2) The prohibitions in this paragraph shall not apply to allocations of shares of a new issue to any account described in Rule 5130(c)(1) through (3) and (5) through [(10)] (11), or to any other account in which the beneficial interests of executive officers and directors of the company and persons materially supported by such executive officers and directors in the aggregate do not exceed 25% of such account.

(c) No Change.

(d) New Issue Pricing and Trading Practices

In a new issue:

(1) No Change.

(2) Lock-Up Agreements. Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer entered into in connection with a new issue shall provide that:

(A) Any lock-up agreement or other restriction on the transfer of the issuer's shares by officers and directors of the issuer shall provide that such restrictions will apply to their issuer-directed shares; and

(B) At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, the book-running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a major news service, except where the release or waiver is effected solely to permit a transfer of securities that is not for consideration or that is to an immediate family member as defined in Rule 5130(i)(5) and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor;

(3) through (4) No Change.

(e) Definitions

(1) through (2) No Change.

(3) “Covered non-public company” means any non-public company, except for an unaffiliated charitable organization, satisfying the following criteria: (i) income of at least \$1 million in the last fiscal year or in two of the last three fiscal years and shareholders’ equity of at least \$15 million; (ii) shareholders’ equity of at least \$30 million and a two-year operating history; or (iii) total assets and total revenue of at least \$75 million in the latest fiscal year or in two of the last three fiscal years.

(4) through (9) No Change.

(f) No Change.

• • • Supplementary Material: -----

.01 Issuer Directed Allocations. The prohibitions of paragraph (b) above shall not apply to allocations of securities that are directed in writing by the issuer, [its] an affiliate[s] of the issuer, or a selling shareholder[s], so long as the member has no involvement or influence, directly or indirectly, in the allocation decisions of the issuer, [its] an affiliate[s], or a selling shareholder[s] with respect to such issuer-directed securities.

.02 No Change.

.03 Lock-up Announcements. For the purposes of this Rule, the requirement that the book-running lead manager announce the impending release or waiver of a lock-up or other restriction on the transfer of the issuer’s shares shall be deemed satisfied where such announcement is made by the book-running lead manager, another member or the issuer, so long as such announcement otherwise complies with the requirements of paragraph (d)(2) of this Rule. In addition, the disclosure of a release or waiver in a publicly filed registration statement in connection with a secondary offering satisfies the requirement for an announcement through a major news service.

.04 Anti-Dilution Provisions. The prohibitions of paragraph (b) above shall not apply to an account in which an executive officer or director of a public company or a covered non-public company, or a person materially supported by such executive officer or director, has a beneficial interest that meets the following conditions:

(a) the account has held an equity ownership interest in the issuer, or a company that has been acquired by the issuer in the past year, for a period of one year prior to the effective date of the offering;

(b) the allocation of the new issue to the account shall not increase the account's percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement in connection with the offering;

(c) the allocation of the new issue to the account shall not include any special terms; and

(d) the new issue allocated pursuant to this Supplementary Material .04 shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

.05 Application to Foreign Non-Member Broker-Dealers Participating in an Underwriting Syndicate. The prohibitions of paragraph (b) above shall not apply to a foreign non-member broker-dealer that is participating in an underwriting syndicate for the sale of a new issue (which underwriting syndicate may include a member affiliate of the non-member broker-dealer) and allocating new issue securities to a non-U.S. person, provided that such allocation decision is not made at the direction or request of a member or an associated person of a member.

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