

**FINRA GUIDANCE ON RECENT AMENDMENTS TO FINRA RULES
RELATING TO SEC REGULATION M**

The Financial Industry Regulatory Authority, Inc. (“FINRA”) recently issued its Regulatory Notice 08-74,¹ outlining changes to its rules which require FINRA member firms participating in securities offerings to file distribution-related information with FINRA’s Market Regulation Department² concerning the firms’ compliance with SEC Regulation M.

Summary

These rule changes, which went into effect on December 15, 2008,

- (1) adopt new FINRA Rule 5190, which provides notification requirements under SEC Regulation M applicable to securities broker-dealers participating in securities offerings;
- (2) adopt new FINRA Rule 6470, which now applies certain Regulation M-related OTC Bulletin Board (“OTCBB”) rules to all OTC Equity Securities;³ and
- (3) make conforming amendments to the Regulation M-related rules applicable to the Alternative Display Facility (“ADF”).⁴

Regulation M

Regulation M is designed to prevent manipulative conduct by persons with an interest in the outcome of a securities offering. It generally prohibits underwriters, broker-dealers, issuers and other persons participating in a distribution of securities from directly or indirectly bidding for or purchasing the offered security (or inducing another person to do so) during the applicable

¹ Regulatory Notice 08-74, <http://www.finra.org/Industry/Regulation/Notices/2008/P117502>.

² The FINRA member firm acting as manager (or in a similar capacity) is responsible for notifying FINRA. If no member firm is acting as manager (or in a similar capacity), then each firm that is a distribution participant or affiliated purchaser is required to notify FINRA, unless another member firm has assumed responsibility in writing for compliance with the notification requirement. A firm that is an issuer or selling security holder must comply with the notification requirements unless another member firm has assumed responsibility in writing for compliance with those requirements. Similarly, a firm that intends to impose a penalty bid or effect a syndicate covering transaction is responsible for notifying FINRA, unless another member firm has assumed responsibility in writing for compliance with the rule.

³ “OTC Equity Security” is defined in new FINRA Rule 6420 as including all non-exchange listed securities such as OTCBB and Pink Sheets securities, and certain exchange listed securities that do not otherwise qualify for real-time trading reporting.

⁴ The Alternative Display Facility is operated by FINRA for members that choose to quote or effect trades in National Market System stock otherwise than on an exchange.

“restricted period.” The restricted period commences on the later of either (i) one or five business days prior to the determination of the offering price (depending on the security being distributed),⁵ or (ii) such time that a person becomes a distribution participant, and ends upon the completion of such person’s participation in the distribution.

Rule 105 of Regulation M prohibits any person from selling short a security that is the subject of a public offering and purchasing the security in the offering, if such short sale was effected during the Rule 105 restricted period (generally the five business day period prior to pricing).

Rule 104 of Regulation M governs certain market activities (*i.e.*, stabilizing bids, syndicate covering transactions and penalty bids) in connection with an offering and it requires that notification of such activity be provided to the relevant self-regulatory organization or, in the case of stabilizing bids, the market where the stabilizing bid is to be posted.

New FINRA Rule 5190

New FINRA Rule 5190 consolidates some of the Regulation M-related notification requirements that were previously found in NASD Rule 2710(b)(10) and (b)(11) and NYSE Rule 392. New Rule 5190, unlike prior rules, applies uniformly to distributions of listed and unlisted securities.

Rule 5190(c)(1) sets forth the notification requirements applicable to distributions of listed and unlisted securities that are subject to a restricted period under Rule 101 or 102 of Regulation M.

Restricted Period Notification

Specifically, FINRA member firms must notify FINRA in writing of the firm’s determination as to whether the Regulation M restricted period prior to pricing (either one business day or five business days, depending on the security being distributed) applies to an upcoming distribution, the basis for such determination, the contemplated date and time of commencement of the restricted period, the security name and symbol and must list the distribution participants and

⁵ “Actively traded” securities are defined in Regulation M as securities with an ADTV value of at least \$1 million, where the issuer’s common equity securities have a public float value of at least \$150 million. They are exempted from Rule 101 of Regulation M. For all other securities, the restricted period varies with the size of the market for the issuer’s securities. For a distribution of a security with an ADTV value of at least \$100,000, whose issuer has outstanding common equity securities having a public float value of at least \$25 million, the restricted period begins one business day prior to pricing (or the date on which the person becomes a distribution participant). The restricted period begins five business days prior to pricing (or the date on which the person becomes a distribution participant) for a distribution of any other security. ADTV is defined in Rule 100(b) of Regulation M as the worldwide average daily trading volume during the two full calendar months immediately preceding, or any 60 day consecutive calendar days ending within the 10 calendar days preceding, the filing of the registration statement; or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to Rule 415, two full calendar months immediately preceding, or any 60 calendar days ending within the 10 calendar days preceding, the determination of the offering price.

affiliated purchasers. Under the new rule, firms are not required to submit a copy of the registration statement or other offering documents to FINRA's Market Regulation Department.

The notification must be provided no later than the business day prior to the first complete trading session of the applicable restricted period,⁶ unless later notification is necessary under specific circumstances.⁷

Pricing Notification

In addition, Rule 5190(c)(1)(B) requires notification to FINRA upon pricing a distribution that is subject to a restricted period under Regulation M. The notification must include: security name and symbol; type of security; number of shares offered; offering price; last sale before the distribution (*i.e.*, the last sale before pricing); pricing basis (*e.g.*, a discount to the last sale price, a negotiated price, best efforts at the market, etc.); SEC effective date and time; trade date (*i.e.*, the first trade date that the shares from the distribution are available for trading in the aftermarket); restricted period (*i.e.*, the first and last trade dates of the actual restricted period); and identity of the distribution participants and affiliated purchasers.

Firms must submit the notification no later than the close of business the next business day following the pricing of the distribution, unless later notification is necessary under specific circumstances.⁸

Canceled or Postponed Offering

Firms must also notify FINRA immediately in writing if they cancel or postpone any distribution for which prior notice of commencement of the restricted period has been provided.

Requirements Applicable to Distributions of "Actively Traded" Securities

Rule 5190(d) sets forth the notification requirements applicable to distributions of listed and unlisted securities that are considered "actively traded" securities and thus are not subject to a restricted period under Rule 101 of Regulation M.⁹

⁶ Where the principal market closes early (*e.g.*, for a holiday), the shortened session would constitute a complete trading session for purposes of the rule.

⁷ FINRA, on a case-by-case basis, may allow later notification where it was impossible to provide timely notice. In Regulatory Notice 08-74 FINRA provides, as an example, a Private Investment in Public Equity ("PIPE"), offering commenced and priced on the same day.

⁸ *See supra* note 7.

⁹ "Actively traded" securities are excepted from the restrictions in Rule 101, which apply to underwriters and brokers-dealers, or affiliates, but not from those in Rule 102 of Regulation M, which apply to the issuer, selling shareholder or affiliates.

FINRA member firms must also notify FINRA, at least one business day prior to the pricing of the distribution, in writing of the firm's determination that securities are "actively traded" and thus no restricted period applies and the basis for such determination, unless later notification is necessary under specific circumstances.¹⁰

Upon pricing a distribution of an "actively traded" security, FINRA member firms must provide, no later than the close of business the next business day following the pricing of the distribution, (unless later notification is necessary under specific circumstances),¹¹ written notification to FINRA, including the pricing-related information required under Rule 5190(c)(1)(B), discussed above, and identify the distribution participants and affiliated purchasers.

Rule 5190(c)(2) provides, however, that any FINRA member firm that is *also* an issuer or selling security holder in a distribution of a security, including an "actively traded" security, and thus subject to a restricted period under Rule 102 of Regulation M, must comply with the notification requirements of Rule 5190(c)(1), discussed above.

Penalty Bids and Syndicate Covering Transactions in OTC Equity Securities

Rule 5190(e) requires FINRA member firms to (i) notify FINRA of their intention to conduct penalty bids or syndicate covering transactions in connection with an offering of OTC Equity Securities, prior to imposing the penalty bid or engaging in the first syndicate covering transaction, (ii) identify the security and its symbol and the date such activity will occur, then confirm such activity within one business day of completion, and (iii) identify the security and its symbol, the total number of shares and the date(s) of such activity.

These requirements are substantially similar to the current OTCBB rules; however, the amendments clarify that they apply to distributions of *all* OTC Equity Securities and are not limited to distributions of OTCBB-eligible securities.

Responsibility for Submission of Notice to FINRA under Rule 5190

The FINRA member firm acting as manager (or in a similar capacity) is responsible for notifying FINRA of the distribution. If no member firm is acting as manager (or in a similar capacity), then each firm that is a distribution participant or affiliated purchaser is required to notify FINRA, unless another member firm has assumed responsibility in writing for compliance with the notification requirement. Pursuant to Rule 5190(c)(2), a firm that is an issuer or selling security holder must comply with the notification requirements of paragraph (c)(1), unless another member firm has assumed responsibility in writing for compliance with those requirements. Similarly, pursuant to Rule 5190(e), a firm that intends to impose a penalty bid or

¹⁰ See *supra* note 7.

¹¹ See *supra* note 7.

effect a syndicate covering transaction is responsible for notifying FINRA, unless another member firm has assumed responsibility in writing for compliance with the rule.¹²

Regulatory Notice 08-74 includes the following chart outlining which forms should be used to provide notification under the various sections of Rule 5190. Copies of the forms are also reproduced in the Regulatory Notice.

Notification Requirement	Rule	Form
Determination of applicable restricted period, including contemplated commencement of restricted period	5190(c)(1)(A)	Regulation M Restricted Period Notification
Determination that no restricted period applies under the “actively traded” securities exception	5190(d)(1)	Regulation M Restricted Period Notification
Pricing of distribution (applicable to distributions subject to a restricted period and distributions of “actively traded” securities)	5190(c)(1)(B) 5190(d)(2)	Regulation M Trading Notification
Cancellation or postponement of distribution (applicable where prior notice of commencement of restricted period has been provided)	5190(c)(1)(C)	Regulation M Restricted Period Notification
Intent to effect syndicate covering transaction	5190(e)(1)	Regulation M Notice of Intent to Impose a Penalty Bid and/or Effect a Syndicate Covering Transaction
Confirmation of syndicate covering transaction	5190(e)(2)	Regulation M Trading Notification

¹² FINRA member firms must update any notification submitted to the Market Regulation Department, as necessary (e.g., if distribution participants were added after the restricted period commenced or if a deal was oversubscribed and the over-allotment option was exercised).

Notification Requirement	Rule	Form
Intent to impose penalty bid	5190(e)(1)	Regulation M Notice of Intent to Impose a Penalty Bid and/or Effect a Syndicate Covering Transaction
Confirmation of penalty bid	5190(e)(2)	Regulation M Trading Notification

Nasdaq Reporting

Nasdaq Stock Exchange rules impose certain notification requirements that are similar to those of Rule 5190. The notification forms that have been designed to satisfy FINRA rules also include fields for purposes of compliance with the comparable Nasdaq Stock Exchange rules so firms that have an obligation under both FINRA and the similar Nasdaq Stock Exchange rules are not required to submit two separate filings to FINRA's Market Regulation Department.¹³

New FINRA Rule 6470 Relating to OTC Equity Securities

New FINRA Rule 6470 (Withdrawal of Quotations in an OTC Equity Security in Compliance with SEC Regulation M) requires that, in connection with a distribution of an OTC Equity Security, a firm must withdraw its quotations in the offered security to comply with the applicable restricted period under Regulation M. In addition, Rule 6470 prohibits the entry of stabilizing bids for OTC Equity Securities pursuant to Rule 104 of Regulation M. Rule 6470 does not impose a notification requirement since member firms can withdraw their quotations in OTC Equity Securities without first requesting excused withdrawal status (as required under ADF rules).

Rule 6470 is substantially similar to current OTCBB rules, but the amendments clarify that the requirements apply not only to OTCBB-eligible securities, but to all OTC Equity Securities quoted in any inter-dealer quotation system (*e.g.*, OTCBB and Pink Sheets).

¹³ However, firms must also comply with requirements under the Nasdaq Stock Exchange rules to provide notice to Nasdaq or Nasdaq MarketWatch, as applicable.

Amendments to FINRA Rule 6275 relating to ADF Market Makers

To conform with new FINRA Rule 6470, FINRA Rule 6275(f) (previously NASD Rule 4619A(f)) has been amended to require that, in connection with a distribution of an NMS stock, an ADF Market Maker must submit a written request to ADF Operations and FINRA's Market Regulation Department to withdraw its quotations in the offered security in the ADF to comply with the applicable restricted period under Regulation M. The request must be submitted no later than the business day prior to the first complete trading session of the restricted period under Regulation M, unless under the specific circumstances, later notification is necessary.¹⁴

An ADF Market Maker also must submit a written request to ADF Operations and FINRA's Market Regulation Department to rescind the firm's excused withdrawal status. As part of that request, the firm must notify FINRA of the date and time of the pricing of the offering, the offering price and the time the offering terminated. The notice must be submitted no later than the close of business the next business day following the pricing of the distribution.

The ADF Market Maker that is posting quotations in the ADF has the obligation to request excused withdrawal status and to subsequently rescind excused withdrawal status, unless another FINRA member firm has assumed responsibility in writing for compliance on the ADF Market Maker's behalf. As amended, the rule no longer requires the manager of the distribution to submit the request on behalf of each firm participating in the distribution but, a member firm acting as manager can agree, in writing, to do so on behalf of the firms.

Regulatory Notice 08-74 provides that firms must use the following forms to satisfy their notification obligations under Rule 6275:

Notification Requirement	Rule	Form
Request for excused withdrawal status	6275(f)(1)	Regulation M Restricted Period Notification
Request to rescind excused withdrawal status	6275(f)(2)	Regulation M Trading Notification

¹⁴ See *supra* note 7.

Firms must submit notification forms under Rules 5190 and 6275 to FINRA's Market Regulation Department via email to secondaryofferings@finra.org; fax to (301) 339-7403; or to a third-party vendor (e.g., Dealogic, Ipreo). Notices under Rule 6275 must also be submitted to ADF Operations via email to FINRAOperations@finra.org or fax to (240) 386-6225, within the time periods prescribed by the rules.

To further assist member firms, FINRA has indicated it will publish a set of Frequently Asked Questions ("FAQ") to facilitate firms' compliance with the amendments, which will be available on FINRA's Web site.

* * * * *

If you have any questions regarding this memorandum, please contact Roger D. Blanc (212-728-8206, rblanc@willkie.com), Martin R. Miller (212-728-8690, mmiller@willkie.com), Larry E. Bergmann (202-303-1103, lbergmann@willkie.com), Matthew B. Comstock (202-303-1257, mcomstock@willkie.com), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

December 16, 2008

Copyright © 2008 by Willkie Farr & Gallagher LLP.

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or an invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in or any reliance upon this information. Under New York's Code of Professional Responsibility, this material may constitute attorney advertising. Prior results do not guarantee a similar outcome.