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Client Alert

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RECENTLY PROMULGATED FINANCIAL INDUSTRY REGULATORY AUTHORITY RULES RELATED TO REGULATION M

Recently, the United States Securities and Exchange Commission (“SEC”) approved new Financial Industry Regulatory Authority (“FINRA”) Rules 5190 and 6470 and amended FINRA Rule 6275, all of which relate to the obligations of broker-dealers under Regulation M.¹ The rule changes took effect on December 15, 2008. Generally, Regulation M prohibits broker-dealers and certain other entities participating in a securities offering from purchasing the offered security during a restricted period imposed during the offering. Regulation M’s policy goal is to control market manipulation during stock offerings by offering participants. Regulation M also governs a broker-dealer’s market-making and similar activities in connection with an offering and requires that it provide related notices to its self regulatory organization (“SRO”) to enable the SRO and SEC to police compliance. We summarize below material highlights of the rule changes.

New FINRA Rule 5190 (Notification Requirements for Offering Participants)

New FINRA Rule 5190 now consolidates the Regulation M-related notification requirements that were previously found in National Association

of Securities Dealers (“NASD”) Rule 2710 (Corporate Financing Rule – Underwriting Terms and Arrangements) and New York Stock Exchange (“NYSE”) Rule 392. Notably, while old NASD Rule 2710 applied only to listed securities, the new Rule 5190 applies to both listed and unlisted securities. Under Rule 5190, broker-dealers must provide specified notices to FINRA in connection with offerings of listed and unlisted securities that are subject to a restricted period under Rule 101 or 102 of Regulation M.

General Requirements where Regulation M “restricted period” applies

Under Rule 5190(c)(1), FINRA member firms must notify FINRA of the firm’s determination as to (1) whether the Regulation M restricted period prior to pricing applies to a scheduled offering, (2) the basis for such determination, (3) the contemplated timing for the restricted period, (4) the security name and symbol and (5) the distribution participants and affiliated purchasers. No offering documents or SEC filings need be provided to FINRA. Generally, notification is required no later than the business day prior to the first complete trading session of the applicable restricted period, subject to limited exceptions.

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¹ FINRA issued related guidance in Regulatory Notice 08-74, including the specific forms to be used to comply with the reporting requirements.

A further notification must be given to FINRA at the pricing of a security subject to a restricted period under Regulation M.² Pricing notification is generally required to be made no later than the close of business the next business day following the pricing of the distribution. Immediate notice of cancellation or delay of any distribution for which prior notice of commencement of the restricted period has been provided must be given to FINRA.

Actively Traded Securities

Distributions of listed and unlisted securities that are considered “actively traded” securities are not subject to a restricted period under Rule 101 of Regulation M (Rule 102 still applies). In this case, Rule 5190(d) generally requires FINRA member firms to notify FINRA, at least one business day prior to the pricing of the distribution, if the firm determines securities are “actively traded” and thus no restricted period applies, the basis for this determination and the security name and symbol. When an “actively traded” security prices, FINRA member firms must provide a notice to FINRA containing the pricing-related information required under Rule 5190 discussed above.

If a FINRA member firm is also an issuer or selling security holder in a distribution, whether or not involving an “actively traded” security, and is thus subject to a restricted period under Rule 102, the firm must also comply with the notification requirements of Rule 5190(c)(1), discussed above.

Penalty Bids and Syndicate Covering Transactions in Over the Counter (“OTC”) Equity Securities

Under FINRA Rule 5190(e), member firms must inform FINRA of their intention to conduct penalty bids or syndicate covering transactions in connection with an offering of OTC Equity Securities (as defined in FINRA Rule 6420(d)), prior to engaging in these activities. The notice must identify the security, its symbol and the date such activity will occur. A follow up notice is required to confirm such activity within one business day of its completion, which again identifies the security and its symbol, the total number of shares and the date(s) of the activity.

Submission of Notice to FINRA under Rule 5190; Related Considerations

The FINRA member firm acting as manager or in a similar role is responsible for satisfying the FINRA notice requirements in connection with the distribution. All notifications must be in writing. If there is no manager, then each firm that is a distribution participant or affiliated

² The notification must include: security name and symbol, type of security, amount of securities offered, offering price, last sale before the distribution (in practice, the last sale before pricing), the method for pricing, the effective date and time for registration with the SEC, the trade date, the applicable restricted period under Regulation M and the identity of the distribution participants and affiliated purchasers.

purchaser is required to provide notice to FINRA, unless another member firm has agreed in writing to comply with the notification requirement on behalf of the syndicate. In addition, any firm that is an issuer or selling security holder or is imposing a penalty bid must comply with the notification requirements of 5190 on its own behalf, unless another member firm has agreed in writing to comply with the notification requirement on behalf of the syndicate. Regulation M notification forms satisfy both FINRA rules and comparable Nasdaq Stock Exchange (“Nasdaq”) rules, so there is no obligation to submit a separate Nasdaq filing to FINRA’s Market Regulation Department. It should be noted that an independent obligation exists to comply with any filings required by Nasdaq if applicable.

New FINRA Rule 6470 Relating to OTC Equity Securities

New FINRA Rule 6470 requires that a firm participating in a distribution of an OTC Equity Security must withdraw its quotations in the offered security to comply with the applicable restricted period under Regulation M. Pursuant to Rule 104 of Regulation M, Rule 6470 also prohibits the entry of stabilizing bids for OTC Equity Securities in these circumstances. There is no notification requirement under FINRA Rule 6470.

Lastly, the amendments to Rule 6470 clarified that the requirements apply not only to OTC Bulletin Board-eligible securities, but to all OTC Equity Securities quoted in any inter-dealer quotation system including those that are quoted in the “pink sheets” as well as those traded on the Bulletin Board.

Amendments to FINRA Rule 6275 (Withdrawal of Quotations in an OTC Equity Security in Compliance with SEC Regulation M)

Under amended FINRA Rule 6275(f), an Alternative Display Facility Market Maker (“ADF Market Maker”) required to comply with a restricted period under Regulation M must, in connection with a distribution of security, submit a written request to both Alternative Display Facility Operations and FINRA’s Market Regulation Department to withdraw its quotations in the offered security. Generally, this request must be submitted no later than the business day prior to the first complete trading session of the restricted period under Regulation M. An ADF Market Maker also must submit a written request to ADF Operations and FINRA’s Market Regulation Department to rescind the firm’s request.³ The ADF Market Maker that is posting quotations in the ADF must make the required filings, unless another FINRA member firm has assumed responsibility in writing for such filings. The manager of the distribution is no longer required 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 other firms.

³ This request must notify FINRA of the date and time of the pricing of the offering, the offering price and the time the offering terminated and must be submitted no later than the close of business the next business day following the pricing.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Global Securities Group, whose names and contact information are provided below.

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