



FINRA Proposes Amendments to Offering Rules Regarding Conflicts of Interest and Qualified Independent Underwriters

The Proposed Amendments

In May 2009, the Financial Industry Regulatory Authority (FINRA) published for comment a series of proposed amendments to NASD Rule 2720 (Distribution of Securities of Members and Affiliates – Conflicts of Interest) and FINRA Rule 5110 (Corporate Financing Rule). These proposed amendments substantially replace the rule changes proposed on September 6, 2007, which have been under review since filing, and would revise the FINRA review and approval process of public offerings of securities in which participating member firms have conflicts of interest.

The proposed rule change would replace the current NASD Rule 2720 with a new Rule 2720, to be entitled "Public Offerings of Securities With Conflicts of Interest." The new Rule 2720 would revise the FINRA filing requirements for certain offerings involving conflicts of interest, alter the role of the qualified independent underwriter (QIU) and provide additional disclosure requirements.

Some of the more significant elements of the proposed amendments are as follows:

- Public offerings of investment grade-rated securities or of securities that have a "bona fide public market" would be exempt from the FINRA filing and QIU requirements, irrespective of a member firm conflict of interest.
- Public offerings in which the lead manager(s) do not have a conflict of interest would likewise be exempt from FINRA review and the requirement of QIU participation, whether or not other participating member firms may have a conflict of interest.

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- A conflict of interest would exist if:
 - the securities are to be issued by the member firm or by an entity controlling, controlled by or under common control with the member firm, with "control" including a 10-percent beneficial ownership stake;
 - at least 5 percent (not 10 percent, as the current rule provides) of the net offering proceeds are intended to be used to repay indebtedness owed to the member firm or its affiliates, or are otherwise directed to the member firm and its affiliates; or
 - as a result of the public offering, the member firm will be an affiliate of the issuer or the issuer will become a member firm.
- Offering documents would be required to contain more prominent disclosure of member firm conflicts of interest. The proposal suggests that adding the notation "(Conflicts of Interest)" to the Plan of Distribution (or corresponding section) reference in the offering document's table of contents and providing disclosure regarding the conflict of interest in the Plan of Distribution and the prospectus summary would be considered a non-exclusive safe harbor for meeting the disclosure requirement.
- A QIU would no longer be required to render a pricing opinion. Rather, a QIU would have to participate in the preparation of the offering document and exercise customary standards of due diligence. The proposed rule would require "prominent disclosure" of the existence of a conflict of interest and of the name of the member firm acting as QIU and the responsibilities of a QIU.

Regulatory Focus on Conflicts of Interest Continues

Although proposed amendments to the member firm conflicts of interest rules have been in the works for several years, the current revised formulation shows the increased focus being placed by regulators on conflicts of interest involving market participants, notably with the more stringent definition of "conflict of interest" and the addition of more specific disclosure requirements. The elimination of the archaic QIU pricing opinion requirement, in favor of an emphasis on QIU due diligence, streamlines the offering process and reflects actual market practice more closely, but also indicates a regulatory concern with ensuring appropriate process in public offerings involving conflicts of interest, rather than just mandating a second opinion on the pricing outcome.

If you have any questions regarding this rule proposal

or would like further information regarding any of the matters discussed above, please contact [Daniel G. Berick](#) or your principal Squire Sanders lawyer.

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