

## Fixed Price Offerings

### FINRA Requests Comment on Proposed Consolidated FINRA Rule Governing Sale of Securities in a Fixed Price Offering

Comment Period Expires: September 18, 2009

#### Executive Summary

As part of the process to develop a new consolidated rulebook (the Consolidated FINRA Rulebook),<sup>1</sup> FINRA is requesting comment on a proposed new rule governing fixed price offerings. Proposed FINRA Rule 5141 (Sale of Securities in a Fixed Price Offering) would be a new consolidated rule that simplifies the provisions of current NASD Rules 2730, 2740 and 2750 and their associated Interpretive Materials and eliminates outdated requirements.

The text of the proposed rule is set forth in Attachment A.

Questions regarding this *Notice* should be directed to:

- Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or
- Adam H. Arkel, Assistant General Counsel, OGC, at (202) 728-6961.

#### August 2009

##### Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

##### Suggested Routing

- Corporate Financing
- Compliance
- Legal
- Operations
- Senior Management

##### Key Topic(s)

- Fixed Price Offerings
- Papilsky Rules

##### Referenced Rules & Notices

- NASD Rule 2730
- NASD Rule 2740
- NASD Rule 2750
- NASD IM-2730
- NASD IM-2740
- NASD IM-2750
- NTM 03-73
- FINRA Rule 5130

## Action Requested

FINRA encourages all interested parties to comment on the proposed rule. Comments must be received by September 18, 2009.

Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, N.W.  
Washington, D.C. 20006-1506

To help FINRA process and review comments more efficiently, persons should only use one method to comment on the proposal.

**Important Notes:** The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this Notice will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.<sup>2</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.<sup>3</sup>

## Background

NASD Rules 2730, 2740 and 2750 and their associated Interpretive Materials (IMs) regulate fixed price offerings.<sup>4</sup> Generally, the purpose of the rules and the associated IMs<sup>5</sup> is to protect the integrity of fixed price offerings by ensuring that securities in such offerings are sold to the public at the stated public offering price or prices, thereby preventing an undisclosed better price. The rules reach this goal by prohibiting the grant or reallowance of certain preferences (*e.g.*, discounts, selling concessions, underwriting recapture or various economic equivalents) to persons outside of the selling groups and selling syndicates<sup>6</sup> formed to distribute the offered securities.<sup>7</sup>

FINRA believes that, though the fixed price offering rules continue to play an important role in protecting market integrity, certain requirements of the rules have become outdated. Accordingly, FINRA is proposing to delete NASD Rules 2730, 2740, 2750 and their associated IMs in their entirety from FINRA's rulebook and to adopt a single, simplified rule—proposed FINRA Rule 5141—in their place.

## Proposed FINRA Rule 5141

Like the current fixed price offering rules, the goal of proposed FINRA Rule 5141 is to ensure that, if an offering is presented to the public as a fixed price offering, then the public should be able to have confidence that no one is able to gain an unfair advantage by obtaining the securities at less than the stated public offering price. Paragraph (a) of the proposed rule addresses this core objective by providing that no member or person associated with a member that participates in a selling syndicate or selling group in connection with a fixed price offering may offer or grant, directly or indirectly, to any person<sup>8</sup> or account that is not a member of such selling syndicate or selling group any securities in the offering at a price below the stated public offering price (*i.e.*, a “reduced price”).

The proposed rule provides that, subject to the requirements of FINRA Rule 5130, a member of a selling syndicate or selling group is permitted to sell securities in the offering to an affiliated person, provided the member does not sell the securities to the affiliated person at a reduced price (as set forth under the rule).<sup>9</sup> The requirements of the proposed rule would apply until the termination of the offering.

Proposed FINRA Rule 5141(b) provides that nothing in the rule shall prohibit the purchase and sale of securities in a fixed price offering between members of the selling syndicate or selling group.

The proposed rule contains supplementary material that elaborates the concept of “reduced price” and prohibits various means—addressed in the current fixed price offering rules—by which the economic equivalent of a reduced price could be offered or granted. The supplementary material largely preserves NASD Rule 2740’s exclusion for research services. Further, the supplementary material generally protects ordinary-course business transactions between members of a selling syndicate or selling group members and affiliates from being deemed transactions that confer a reduced price. The proposed supplementary material provides the following:

- ▶ **Reduced Price:** Proposed FINRA Rule 5141.01 provides that, for purposes of the rule, “reduced price” includes, without limitation, any offer or grant of any selling concession, discount or other allowance, credit, rebate, reduction of any fee (including any advisory or service fee), any sale of products or services at prices below reasonable commercially available rates for similar products or services (except for research, which, as noted below, is subject to proposed FINRA Rule 5141.02), or any purchase of or arrangement to purchase securities from the person or account at more than their fair market price in exchange for securities in the offering;<sup>10</sup>

- ▶ **Research:** Proposed FINRA Rule 5141.02 generally preserves the allowance that NASD Rule 2740 makes with respect to research services. Specifically, the supplementary material provides that nothing in the new rule prohibits a member or person associated with a member that participates in a selling syndicate or selling group from selling securities in the offering to a person or account to which it has provided or will provide research, provided the person or account pays the stated public offering price for the securities and the research is in conformity with the requirements of Exchange Act Section 28(e)(3)(A) and (B) and SEC guidance. The supplementary material provides, like the current NASD rule, that investment management or investment discretionary services are not research. The supplementary material further requires that any product or service provided by a member or person associated with a member that does not qualify as research must not confer a reduced price as set forth in proposed FINRA Rule 5141.01;
- ▶ **Ordinary-Course Transactions with Affiliates:** Proposed FINRA Rule 5141.03 provides that transactions between a member of a selling syndicate or selling group and an affiliated person that are part of the normal and ordinary course of business and are unrelated to the sale or purchase of securities in a fixed price offering shall not be deemed to confer a reduced price under the rule;
- ▶ **Definition of Fixed Price Offering:** The supplementary material incorporates the current definition of “fixed price offering” as set forth in NASD Rule 0120(h) with only minor changes, primarily to reflect the new conventions of the Consolidated FINRA Rulebook;
- ▶ **Asset-Based Fees:** Lastly, the rule’s supplementary material clarifies that a member that is an investment adviser may exempt securities that are purchased as part of a fixed price offering from the calculation of annual or periodic asset-based fees that the member charges a customer, provided the exemption is part of the member’s normal and ordinary course of business with the customer and is not in connection with the offering.

## Endnotes

- 1 The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA member firms, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). The FINRA Rules apply to all FINRA member firms, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see *Information Notice 03/12/08* (Rulebook Consolidation Process).
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *Notice to Members (NTM) 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See SEA Section 19 and rules thereunder.
- 4 NASD Rule 0120(h) defines the term “fixed price offering” to mean the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act of 1933. The term does not include offerings of “exempted securities” or “municipal securities” as those terms are defined in Sections 3(a)(12) and 3(a)(29), respectively, of the Exchange Act or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act of 1940 which are offered at prices determined by the net asset value of the securities. The definition of “fixed price offering” would be incorporated into the proposed rule in substantially identical form (see proposed FINRA Rule 5141.04).
- 5 The fixed price offering rules are also known as the *Papilsky* rules because of the court decision with which they are commonly associated. See *Papilsky v. Berndt, et al.*, No. 71 Civ. 2534, 1976 U.S. Dist. LEXIS 14442 (S.D.N.Y., June 24, 1976). For more information regarding the rules’ background, see Exchange Act Release No. 17371 (December 12, 1980), 45 FR 83707 (December 19, 1980) (Order Approving Proposed Rule Change; File No. SR-NASD-78-3) (Approval Order). See also Exchange Act Release No. 15807 (May 9, 1979), 44 FR 28574 (May 15, 1979) (Notice of Proposed Rule Change; File No. SR-NASD-78-3); NTM 77-31 (September 23, 1977) (Proposed Rule Changes and Interpretations Concerning Securities Distribution Practices).

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## Endnotes continued

- 6 The terms “selling group” and “selling syndicate” are defined in NASD Rules 0120(p) and (q), respectively. Other than to reflect the new conventions of the Consolidated FINRA Rulebook, FINRA does not propose to alter these definitions, which will be addressed later in the rulebook consolidation process.
- 7 The fixed price offering rules address three broad areas. First, NASD Rule 2730 generally provides that a member, engaged in a fixed price offering, that purchases or arranges the purchase of other securities in connection with or in exchange for the underwritten securities must purchase the other securities at value equating to the current market price at the time of purchase or act as agent in the sale of such securities and charge the commission at the rate applied by members in the normal course of business. (The rule thereby prohibits overtrading.) The rule sets forth, among other things, certain presumptions of compliance versus non-compliance and recordkeeping requirements.
- Second, NASD Rule 2740 generally requires that in connection with a fixed price offering, selling concessions, discounts or other allowances may only be paid to brokers or dealers actually engaged in the investment banking or securities business and only as consideration for services rendered in distribution. (The rule permits an exception where the member has provided, or will provide, “bona fide research” consistent with Exchange Act Section 28(e), if the purchaser pays the stated public offering price for the securities.) The rule sets forth, among other things, certain requirements with respect to written agreements to comply with the rule that members must obtain and interpretive material on “bona fide research,” as well as certain transaction reporting and recordkeeping requirements.
- Third, NASD Rule 2750 generally bars any member engaged in a fixed price offering from selling the securities to, or placing the securities with, any person or account that is a related person of the member, unless the related person is itself subject to the rule or is a non-member broker-dealer that has entered into the agreements required under Rule 2740. (The rule thereby operates to prevent underwriting recapture through an affiliate.) *See also* Approval Order.
- 8 NASD Rule 0120(n) defines “person” to include any natural person, partnership, corporation, association, or other legal entity.
- 9 FINRA Rule 5130 (former NASD Rule 2790) addresses restrictions on the purchase and sale of initial equity public offerings. The rule generally prohibits sales to and purchases by a broker-dealer and accounts in which a broker-dealer has a beneficial interest.
- 10 The supplementary material defines “fair market price” to refer generally to a price or range of prices at which a willing buyer and a willing seller, each unrelated to the other, would purchase the securities in the ordinary course of business in transactions that are of similar size and similar characteristics and are independent of any other transaction.

## ATTACHMENT A

Below is the text of proposed FINRA Rule 5141.

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### 5000. SECURITIES OFFERING AND TRADING STANDARDS AND PRACTICES

#### 5100. SECURITIES OFFERINGS, UNDERWRITING AND COMPENSATION

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#### 5140. Integrity of Fixed Price Offerings

##### 5141. Sale of Securities in a Fixed Price Offering

(a) No member or person associated with a member that participates in a selling syndicate or selling group in connection with a fixed price offering shall offer or grant, directly or indirectly, to any person or account that is not a member of such selling syndicate or selling group any securities in the offering at a price below the stated public offering price (“reduced price”). Subject to the requirements of Rule 5130, a member of a selling syndicate or selling group is permitted to sell securities in the offering to an affiliated person, provided such member does not sell the securities to the affiliated person at a reduced price under this Rule. The requirements of this Rule shall apply until the termination of the offering.

(b) Nothing in this Rule shall prohibit the purchase and sale of securities in a fixed price offering between members of the selling syndicate or selling group.

• • • Supplementary Material: — — — — —

**.01 Reduced Price.** For the purposes of this Rule, “reduced price” includes, without limitation, any offer or grant of any selling concession, discount or other allowance, credit, rebate, reduction of any fee (including any advisory or service fee), any sale of products or services at prices below reasonable commercially available rates for similar products and services (except for research subject to Rule 5141.02), or any purchase of or arrangement to purchase securities from the person or account at more than their fair market price in exchange for securities in the offering. For purposes of this Supplementary Material, “fair market price” refers generally to a price or range of prices at which a willing buyer and a willing seller, each unrelated to the other, would purchase the securities in the ordinary course of business in transactions that are of similar size and similar characteristics and are independent of any other transaction.

**.02 Research.** Nothing in this Rule shall prevent a member or person associated with a member that participates in a selling syndicate or selling group from selling securities in the offering to a person or account to which it has provided or will provide research, provided the person or account pays the stated public offering price for the securities and the research is in conformity with the requirements of Section 28(e)(3)(A) and (B) of the Exchange Act and SEC guidance. Investment management or investment discretionary services are not research for purposes of this Supplementary Material. Any product or service provided by a member or person associated with a member that does not qualify as research under this Supplementary Material must not confer a reduced price as set forth in Rule 5141.01.

**.03 Affiliated Persons.** Transactions between a member of a selling syndicate or selling group and an affiliated person that are part of the normal and ordinary course of business and are unrelated to the sale or purchase of securities in a fixed price offering shall not be deemed to confer a reduced price under this Rule.

**.04 Fixed Price Offering.** The term “fixed price offering” means the offering of securities at a stated public offering price or prices, all or part of which securities are publicly offered in the United States or any territory thereof, whether or not registered under the Securities Act, except that the term does not include offerings of “exempted securities” or “municipal securities” as those terms are defined in Sections 3(a)(12) and 3(a)(29), respectively, of the Exchange Act or offerings of redeemable securities of investment companies registered pursuant to the Investment Company Act which are offered at prices determined by the net asset value of the securities.

**.05 Asset-Based Fees.** A member that is an investment adviser may exempt securities that are purchased as part of a fixed price offering from the calculation of annual or periodic asset-based fees that such member charges to a customer, provided such exemption is part of the member’s normal and ordinary course of business with the customer and is not in connection with an offering.

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