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## FINRA Repeals Rule 312(f) Relating to Recommendation by NYSE Member Firms of Affiliate Securities; Retains Broader Disclosure Requirement

### Overview

On September 21, 2009, the Securities and Exchange Commission ("SEC") approved the adoption of certain consolidated FINRA rules relating to disclosures that are required in connection with specific securities transactions.<sup>1</sup>

Among the changes were the adoption of FINRA Rule 2262, which retains NASD Rule 2240 requiring broker-dealers to disclose any affiliation with the issuer of a security in which they are transacting, and the deletion of New York Stock Exchange ("NYSE") Rule 312(f), which relates to transactions involving the securities affiliates.

The SEC's changes, which are a part of FINRA's rulebook consolidation process,<sup>2</sup> are effective as of **December 14, 2009**.

This publication does not purport to be a detailed description or analysis of the issues raised by the Rule. Interested persons should feel free to contact their regular

Shearman & Sterling contacts, or any of the Shearman & Sterling attorneys listed at the end of this client publication.

### FINRA Rule 2262 keeps NASD Rule 2240 in place...

The Adopting Release adopts, among other rules, FINRA Rule 2262 ("Rule 2262"), which is presently designated NASD Rule 2240. Rule 2262:

A member controlled by, controlling, or under common control with, the issuer of any security, shall, before entering into any contract with or for a customer for the purchase or sale of such security, disclose to such customer the existence of such control, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

The text of Rule 2262 is identical to NASD Rule 2240.

Among the noteworthy differences between Rule 2262 and NYSE Rule 312(f) are that:

- Rule 2262 applies to all contracts for the purchase or sale of securities,<sup>3</sup> while Rule 312(f), reproduced below, applies only to solicited and/or recommended transactions; and

<sup>1</sup> See "Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, to Adopt FINRA Rules 2262 (Disclosure of Control Relationship with Issuer), 2269 (Disclosure of Participation or Interest in Primary or Secondary Distribution) and 5260 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts) in the Consolidated FINRA Rulebook", SEC Release No. 34-54368 (August 25, 2006) (the "Adopting Release"). The Adopting Release is currently available on the SEC's Internet Website, [www.sec.gov](http://sec.gov/rules/sro/finra/2009/34-60659.pdf), at <http://sec.gov/rules/sro/finra/2009/34-60659.pdf>.

<sup>2</sup> For more information regarding the FINRA Rulebook consolidation process, See "Report from SIFMA's 40th Annual Compliance and Legal Division Seminar: FINRA Officials Provide an Update on the NASD - NYSE Merger" (April 2008), currently available at: [http://www.shearman.com/cm\\_041408/](http://www.shearman.com/cm_041408/)

<sup>3</sup> Note that both Rule 2262 and NYSE Rule 312(f) apply to transactions in nonpublic securities.

- Rule 2262 applies to all securities, while Rule 312(f) contained an exception for the solicitation or recommendation of investment-grade rated debt.

...while NYSE Rule 312(f) is deleted.

Rules 312(f)(1) and (2) now read as follows:

(f) (1) After the completion of a distribution of its equity or non-investment grade debt securities or those of any organization controlling the member organization or of any Material Associated Person (as used in Rule 17h-1T of the Securities Exchange Act of 1934, as amended) of the member organization, no member organization shall effect any transaction (except on an unsolicited basis) for the account of any customer in, or make any recommendation with respect to, any such security.

(2) Any member organization that makes any recommendation of any equity or non-investment grade debt security issued by any person controlled

by or under common control with such member organization (other than a Material Associated Person) shall promptly disclose to such customer the existence and nature of such control at the time of recommendation and, if this disclosure is not made in writing, shall provide this disclosure in writing prior to the completion of the transaction.

This Rule will be repealed as of **December 14, 2009**.

## Conclusion

The harmonization of overlapping regulation, such as presently exists with respect to NYSE Rule 312(f) and NASD Rule 2240, is a generally welcome event. However, the retained rule – Rule 2262 – is the broader of the two, applying to all contracts for the purchase or sale securities without exception and requiring (i) disclosure of control affiliation at the time of entry into the contract for purchase or sale, and, (ii) if such disclosure is not in writing, written disclosure of such affiliation prior to the completion of the transaction.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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