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FINRA Corporate Financing Department Introduces Same-Day Clearance for Non-Exempt Shelf Offerings of Securities

Introduction

Following consultation with various broker-dealer and law firms, on March 1, 2010, the Corporate Finance Department of the Financial Industry Regulatory Authority (“FINRA”) introduced a same-day clearance process for shelf offering of securities that would otherwise not qualify for an exemption from filing under the FINRA’s Corporate Financing Rule.¹

Under FINRA rule 5110, NASD rule 2720 (the “Conflict of Interest Rule”), and FINRA rule 2310 (together, the “Corporate Financing Rules”), public offerings of securities are required to be filed with FINRA for review and approval prior to the effectiveness of the registration statement unless there is an applicable exemption. Offerings exempt from the FINRA filing requirements include certain shelf offerings² effected pursuant to

Form S-3 or Form F-3 or, for Canadian issuers, Form F-10.³

Filing exemptions may be lost, however, if the member has a conflict of interest, as that term is defined for purposes of the Conflict of Interest Rule. A conflict of interest exists when (1) the issuer is the member itself, (2) the issuer and member are affiliates as determined by NASD Rule 2720, or, (3) at least 5% of the net offering proceeds (which does not include underwriting compensation) are intended to be directed to the member or its affiliates or associated persons.

FINRA’s same-day clearance option is available for shelf offerings of securities that do not meet the requirements of the Corporate Financing Rule’s exemptions, including those that have lost that exemption due to the operation of the Conflict of Interest Rule.

The remainder of this memorandum describes the same-day clearance option, and provides certain compliance suggestions for broker-dealers that are considering availing themselves of the same-day clearance option.

Same-Day Clearance

Standard COBRADesk Representations Required

Information regarding offerings is submitted to FINRA using FINRA’s proprietary COBRADesk software. In order to take advantage of the same-day clearance option, FINRA-member broker-dealers must continue to make

¹ FINRA Rule 5110 (the “Corporate Financing Rule”, formerly NASD Rule 2710) regulates the terms and conditions of a FINRA-member broker-dealer’s participation in a public offering. For more information regarding FINRA’s Corporate Financing Rule and the corresponding filing requirements, please see “SEC Approves FINRA Amendments to Conflict of Interest Rules for Securities Offerings” (June 2009), available at <http://www.shearman.com/sec-approves-finra-amendments-to-conflict-of-interest-rules-for-securities-offerings/>; see also “SEC Adopts Major Changes to NASD Corporate Financing Rule” (April 2004), available at http://www.shearman.com/sf_0404/.

² Specifically, FINRA Rule 5110(b)(7)(C) exempts the following offerings from the filing requirements of the Corporate Financing Rule: “offerings of securities: (i) registered with the SEC on registration statement Forms S-3 or F-3 pursuant to the standards for those Forms prior to October 21, 1992 and offered pursuant to Rule 415 of SEC Regulation C; or (ii) of a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory, and is registered with the SEC on Form F-10 pursuant to the standards for that Form approved in Securities Act Release No. 6902 (June 21, 1991) and offered pursuant to Canadian shelf prospectus offering procedures;”

³ Underwriting arrangements for offerings exempted from FINRA filing requirements must nonetheless comply with the substantive requirements of FINRA Rule 5110.

all of the representations required in a standard COBRADesk takedown submission, which includes representations regarding the acquisition of unregistered securities and regarding the presence (or absence) of any conflicts of interest.

One important feature of same-day clearance is that all information provided on COBRADesk must be complete and accurate. Under normal review, members can generally supplement initial COBRADesk submissions with additional information once received. In the case of same-day clearance, however, all information must be complete and accurate as initially submitted, since FINRA will be relying on the information provided to issue its “no objections” opinion. FINRA reserves the right to review the submitted information after the offering has been completed in order to ensure that such information was correct as submitted.

Additional Representations Required

Same-day clearance also requires additional representations regarding the base prospectus and the prospectus supplement. These representations are as follows:

- Additional representations for base prospectus:
 - The registration statement will disclose that the aggregate value of all compensation received or to be received by the participating FINRA members does not exceed 8% of the offering proceeds, or if the registration statement is already effective, this disclosure will be included in any post-effective amendment(s).
 - In the event the offering is subject to Rule 2720, the registration statement or offering circular will comply with the prominent disclosure provisions of that rule.
- Additional representations for takedown prospectus:
 - Terms and arrangements between participating FINRA members and the issuer do not include

any prohibited arrangements as described in FINRA Rule 5110(f)(2).⁴

- Aggregate value of all items of compensation received or to be received by participating FINRA members in connection with the takedown offering does not exceed 8% of the offering proceeds and all underwriting compensation will be disclosed in the “Plan of Distribution”, “Underwriting” or other section of the registration statement, prospectus or offering circular that describes the terms and arrangements entered into by participating FINRA members related to the distribution of the offering.
- Participating FINRA members have not acquired unregistered securities that would be deemed underwriting compensation during the 180-day period preceding the filing.
- In the event that Rule 2720(a)(2) applies to the offering [*i.e.*, a qualified independent underwriter (“QIU”) is being appointed], the qualified independent underwriter has been approved by the Corporate Financing Department within the 12-month period prior to submission of the filing.

Some Compliance Suggestions for FINRA-Member Firms

FINRA-member firms seeking to design compliance programs that can be reasonably expected to achieve compliance with the Corporate Financing Rules in the context of

⁴ Among the underwriting arrangements that are prohibited under FINRA Rule 5110(f)(2) are: the payment of any compensation in connection with an offering of securities that is not completed according to the terms of agreement between the issuer and the underwriter, most “tail fee” arrangements, and certain rights of first refusal in connection with future offerings of securities, including rights of first refusal that have a duration of more than three years from the applicable public offering.

same-day clearance should bear in mind the importance of the accuracy and efficiency of diligence and information gathering, and the importance of recordkeeping demonstrating compliance with the Corporate Financing Rules. Specifically, firms may consider the following possible compliance steps:

- Familiarizing one or more in-house personnel with the additional representations required by same-day clearance, and with how to obtain access to the necessary information on short notice—sometimes less than a day.
- Firms that become aware of forthcoming shelf offerings may wish to implement procedures designed to make applicable legal or compliance personnel aware of the offering and to commence the diligence process, even if a syndicate invitation has not yet been received.
- Because the additional representations apply to all underwriters, lead underwriters may choose to ensure that all syndicate members are able to make applicable representations through the syndicate invitation process.
- Because FINRA may review and inquire into same-day cleared offerings, members may consider keeping separate files demonstrating the applicable diligence and its results.
- Because the same-day clearance form requires any QIU to have been approved by FINRA, member firms may wish to keep their QIU qualification

up-to-date with FINRA, and to establish a compliance calendar in respect of that task.⁵

- Because the prohibitions on “unreasonable terms and arrangements” as defined by FINRA Rule 5110(f)(2) apply also to offerings made via same-day clearance, counsel may wish to review precedent engagement letters and underwriting agreement forms in order to ensure that FINRA will not take issue with any terms and conditions that may be contained in those forms.

Conclusion

The inauguration of same-day clearance provides FINRA members greater flexibility with respect to takedown offerings, and with an alternative to FINRA review for certain time-sensitive offerings. However, the same-day clearance process places a premium on advance preparation, efficient and effective diligence, and good recordkeeping. FINRA-member firms should consider how to best position themselves to reduce potential for regulatory risk at the same time that they take advantage of the same-day clearance option.

⁵ Note that since FINRA's COBRADesk system requires, among other things, information showing that any QIU meets the quantitative standards regarding participation in prior offerings of a specific size in relation to the applicable offering for which a filing is being made, FINRA members may wish to keep up-to-date information regarding their participation in prior transactions.

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.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or any of the following:

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