



FINRA amends new issue rules to broaden exemptions

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The SEC recently approved amendments to FINRA Rules 5130 and 5131 (new issue rules), which govern the offer and sale of “new issue” securities (*i.e.*, equity IPOs). Subject to certain exceptions, Rule 5130 generally prohibits a FINRA member (or an associated person thereof) from selling new issue securities to, or purchasing new issue securities for, an account in which a “restricted person” (as defined in the rule) has a beneficial interest. Subject to certain exceptions, Rule 5131 generally prohibits the allocation of new issue securities by FINRA members to accounts in which an executive officer or director of public company or covered non-public company has a beneficial interest, if such company is a current, former or prospective investment banking client of the FINRA member.

Generally speaking, the amendments to the new issue rules broaden the categories of investors that are exempt from the rules’ restrictions and slightly narrow the types of securities offerings that are subject to the new issue rules. These changes will allow FINRA member broker-dealers to sell new issues to additional kinds of investors and, correspondingly, permit additional kinds of investors to participate in new issues directly or through investments in private investment funds.

Notable changes

The amendments include the following notable changes:

- **US and foreign employee retirement plans.** Rule 5130 contains a general exemption for an ERISA benefits plan that is not sponsored solely by a broker-dealer; however, foreign employee retirement benefits plans, even when similar to qualifying ERISA plans, do not qualify for this particular exemption (although FINRA previously granted exemptive relief to several foreign employee retirement benefits plans). Nor do certain US employee retirement benefits plans. The amended rule adds a general exemption for US and foreign employee retirement plans that (i) have at least 10,000 participants and beneficiaries and \$10 billion in assets; (ii) permit employees regardless of income or position to participate; (iii) are administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants; and (iv) are not sponsored by a broker-dealer. FINRA also amended Rule 5131 to add a corresponding exemption.
- **Foreign investment companies.** Under Rule 5130, an investment company organized under the laws of a foreign jurisdiction is exempt if (i) it is listed on a foreign exchange for sale to the public and (ii) no person owning more than 5 percent of such entity is a restricted person. To address concerns related to the difficulty of ascertaining compliance with the 5 percent limitation, the amended rules broaden that prong of the exemption to also include foreign investment companies that have (a) more than 100 direct investors or (b) more than 1,000 indirect investors. In addition, under the amended rules, foreign investment companies must also not be formed for the specific purpose of permitting “restricted persons” to invest in new issues. This change also results in a corresponding exemption under Rule 5131.
- **Sovereign entity exemption.** Sovereign wealth funds that acquire direct or indirect ownership in broker-dealers in excess of thresholds requiring them to be listed on Form BD were treated as restricted persons for purposes of Rule 5130. The amended rules modify the definition of restricted person to exclude “sovereign entities,” which are defined to include pools of capital, investment funds and other entities owned or controlled by a sovereign nation and created for the purpose of making investments on behalf of or for the benefit of the sovereign nation, its political subdivisions, agencies or instrumentalities. In making this amendment, FINRA noted that sovereign wealth funds were not intended to be within the scope of the rule.
- **Exclusion for foreign offerings.** The amended rules exclude from the definition of new issue offshore offerings made pursuant to Regulation S as well as other offerings made outside of the US, unless the securities offered and sold under Regulation S or in another form of offshore offering are made as part of an offering that is also registered in the US as part of a concurrent IPO of an equity security in the US. Supplementary Material has been added to both rules to clarify that they are not intended to restrict new issue allocations to non-US persons by non-FINRA member foreign broker-dealers participating in an underwriting syndicate, provided that the allocation decisions are not made at the direction or request of a FINRA member or associated person thereof.
- **Exclusion for offerings by SPACs.** Rule 5130 excludes offerings of securities by business development companies, direct participation programs and real estate investment trusts. In response to a comment letter, the amended rule adds an exclusion for offerings by special purpose acquisition companies.
- **Issuer directed securities.** The amended rules expand and clarify the exemption from the prohibitions under the new issue rules for allocations of new issue securities directed by the issuer, an affiliate of the issuer or a selling shareholder, subject to certain conditions. Rule 5130(d) has been amended to clarify that issuer directions must be in writing (a provision already found in Rule 5131).
- **Charitable organizations.** Amended Rule 5131 excludes unaffiliated charitable organizations from the definition of “covered non-public company” on the basis that charitable organizations do not frequently engage in investment banking activities and therefore the risk of impropriety is low.
- **Anti-dilution exemption for Rule 5131.** Rule 5130 allows “restricted persons” that are existing equity owners of an issuer to purchase new issue securities of the issuer in order to maintain their equity ownership position. The supplementary material to Rule 5131 is amended to add a similar exemption, subject to a number of conditions including that (i) the restricted person held equity in the issuer for at least one year prior to the offering of new issue securities, (ii) the allocation of the new issue securities to the account does not increase the percentage equity ownership in the account above the ownership level as of three months prior to the filing of the registration statement in connection with the offering, (iii) the allocation of the new issue securities to the account does not include any special terms and (iv) the acquired new issue securities are not sold or transferred for three months following the effective date of the offering.
- **Family offices and family investment vehicles.** The amendments expand the definition of “family investment vehicle” under Rule 5130 to align with the concept of the family office exclusion under the Investment Advisers Act of 1940, including to capture family investment vehicles that invest on behalf of multiple generations of a family as well as key employees of the family office. The effect is that portfolio managers of these family

investment vehicles are no longer treated as “restricted persons” subject to the restrictions of Rule 5130.

- **Lock-up agreements.** Under Rule 5131, lock-up agreements with officers and directors must require a public announcement at least two business days before release or waiver, except where the transfer is not for consideration and the transferee agrees in writing to the same lock-up terms. The amendments extend this exception to transfers to immediate family members (irrespective of consideration) and provide that disclosure in a publicly filed secondary offering registration statement satisfies the announcement requirement.

Next steps

The amended rules have been approved by the SEC and are expected to be made effective by FINRA shortly. Brokers should update their customer materials to reflect the modifications made to the new issue rules. In addition, investment advisers who advise client accounts and investment funds that invest in new issues should also update their client onboarding materials and subscription documents to reflect the modified rules. The updated documentation should be completed by both new investors and existing investors of these firms. Although the amended rules do not appear to narrow or further restrict the kinds of investors that can participate in new issues and thus a delay in updating and receiving responses to new issues questionnaires may not result in a violation of the rules, we expect that most market participants will promptly update their documentation.

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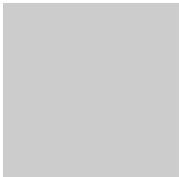
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