


## New rule kicks in concerning conflicts when taking part in a public offering

September 14 is the effective date of **FINRA's** revised rule that governs conflict-of-interest safeguards when broker-dealers participate in a public offering. One of the significant changes deals with the definition of conflict of interest (Regulatory Notice 09-49 .

The new definition of conflict of interest takes compensation, not just ownership, into consideration, noted **Amy Lynch**, president of **FrontLine Compliance, LLC**, a regulatory compliance consulting firm based in Alexandria, Va.

The old version of NASD rule 2720, for instance, viewed a conflict as being triggered when the broker-dealer had an ownership stake - for instance, beneficial ownership of at least 10% of the common equity - in the company conducting the public offering.

But the new rule adds coverage of broker-dealers in situations where at least five percent of the net offering proceeds are intended to be used to reduce the balance of a loan the broker-dealer extended.

The rule prohibits firms with a conflict of interest in a public offering from participating in that offering unless the conflict is prominently disclosed and:

✓ a qualified independent underwriter participates in the offering; or

✓ the firm mainly responsible for *managing* the offering doesn't itself have a conflict and isn't an affiliate of a broker-dealer with a conflict; or

✓ the securities are exchange-listed and are for a bona fide public market or are investment-grade rated by a credit rating agency.

### Discretionary accounts

Firms that have a conflict will continue to be prohibited from making sales of the securities to discretionary accounts unless the firm has specific written approval from the customer.

The new rule additionally requires firms to retain that documentation. "I think that's an area where firms are going to slip up. They'll forget to document it and keep it," Lynch said.

Transactions that broker-dealers make related to the offering should be reviewed by the CCO prior to the transaction closing, Lynch advised.

If you use a qualified independent underwriter, the supervisory person at the QIU who will have due diligence duties must not have been convicted within the past 10 years of violating anti-fraud provisions of federal or state securities laws, or violating regulations issued under those laws.

The old rule applied to convictions in the previous five years.

There are some additional exceptions under which firms wouldn't have to use a QIU, noted Lynch, who said she developed a template for helping firms determine what course to take. ■

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