

CLIENT ADVISORY

March 2009

FINRA PROPOSES NEW LIMITED REPRESENTATIVE REGISTRATION CATEGORY FOR INVESTMENT BANKING PROFESSIONALS

On March 2, 2009, the Securities and Exchange Commission (SEC) published for notice and comment amendments to a proposed rule change that will become effective as early as April 14, 2009, in which the Financial Industry Regulatory Authority, Inc. (FINRA) would establish a new limited registration category for investment banking professionals under NASD Rule 1032(i), Limited Representative-Investment Banking. The proposed rule also sets forth registration requirements for principals who supervise the investment banking activities of those registered under the limited registration category.¹

These amendments address the concern that investment banking personnel should not be required to pass a qualification examination that covers the full range of information required in order to be a securities salesman. Thus, personnel engaged only in investment banking and mergers and acquisitions will only be required to pass examinations that will be more attuned to their professional activities.

We are aware that many non-US broker-dealers with US broker-dealer affiliates have used the “chaperoning” exemption under SEC Rule 15a-6 as a way to facilitate contacts between non-US registered representatives and US institutional investors in investment banking and mergers and acquisitions transactions. Non-US registered representatives involved in these types of transactions have been reluctant to take the General Securities Representative (Series 7) examination (or certain equivalent examinations) because they have not thought that the material covered was relevant to their activities. However, in order to comply with Rule 15a-6, there are strict requirements regarding when a US registered broker-dealer must chaperone the contacts of a non-US registered representative with a US institutional investor, the number of days per year in which in-person contacts within the United States are permitted, and the recordkeeping requirements applicable to the exemption. With the creation of the limited representative registration category for investment banking personnel, non-US broker-dealers may want to take this opportunity to consider, based on the extent and frequency of their reliance on Rule 15a-6, whether it still makes sense for such firms to rely on the chaperoning exemption rather than having these representatives become registered with their FINRA member broker-dealer affiliates in order to carry on these activities under this new qualification category.

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¹ SEC Release No. 34-59484 (March 2, 2009), available at <http://www.sec.gov/rules/sro/finra/2009/34-59484.pdf>.

NASD Rule 1031 currently requires that each person associated with a member broker-dealer who functions as a representative must be registered in a category appropriate to the function that person performs. A “representative” is defined as, among others, a person associated with a member who is “engaged in the investment banking or securities business for the member including the functions of supervision, solicitation, or conduct of business in securities or who [is] engaged in the training of persons associated with a member for any of these functions.” Pursuant to current NASD Rule 1032, a person who functions as a registered representative must pass the Series 7 examination (or equivalent examination), unless such person’s activities are so limited as to qualify him or her for a limited representative category for which a more specific examination is required. Until now, the categories of limited registration have covered registered representatives engaged in investment company/variable contracts, direct participation programs, options and securities futures, corporate securities, equity trading, government securities, and/or private securities offerings.

Under proposed NASD Rule 1032(i), those associated persons of broker-dealers whose activities are limited to investment banking, including those who work on the equity and debt capital markets and syndicate desks, would be eligible for the new limited registration category. The proposed registration category would include those associated persons whose activities primarily involve: (1) advising on or facilitating debt or equity securities offerings through a private placement or a public offering, including but not limited to origination, underwriting, marketing, structuring, syndication, and pricing of such securities and managing the allocation and stabilization activities of such offerings, or (2) advising on or facilitating mergers and acquisitions, tender offers, financial restructurings, asset sales, divestitures or other corporate reorganizations, or business combination transactions, including but not limited to rendering a fairness, solvency, or similar opinion. This new registration category would affect all broker-dealers engaged in investment banking activities (including cross-border) that have associated persons performing the foregoing specified functions. The proposed registration category would not, however, cover individuals whose investment

banking work is limited to municipal financing offerings or direct participation program offerings² or individuals whose investment banking work is limited to effecting private securities offerings³ since these businesses are already covered by other categories in NASD Rule 1032.

FINRA is in the process of developing an accompanying qualification examination that would be taken in lieu of the Series 7 examination (or equivalent examination) for those individuals who perform solely those investment banking functions contemplated by the Limited Representative-Investment Banking registration category. The new qualification examination should provide a more targeted assessment of the job functions performed by individuals engaging in qualifying investment banking activities than what is available under the current NASD Rule 1032. However, any individual whose activities go beyond those contemplated by the new investment banking registration category would still be required to separately qualify and register in an appropriate category of registration under NASD Rule 1032.

It is important to note that FINRA has indicated that individuals who already hold the Series 7 registration, as well as those who have passed the United Kingdom (Series 17) or Canada (Series 37/38) Modules of the Series 7 examination or hold a Limited Representative-Corporate Securities (Series 62) registration, would be “grandfathered”

2 NASD Rule 1022(e)(2) defines “direct participation programs” as programs that “provide for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, cattle programs, condominium securities, Subchapter S corporate offerings, and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. Excluded from this definition are real estate investment trusts, tax qualified pension, and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code (Code) and individual retirement plans under Section 408 of the Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Code and any company including separate accounts registered pursuant to the Investment Company Act of 1940. Also excluded from this definition is any program that is listed on a national securities exchange or any program for which an application for listing on a national securities exchange has been made.”

3 NASD Rule 1032(h)(1)(A) defines “private securities offerings” as activities in the investment banking and securities business that “involve effecting sales as part of a primary offering of securities not involving a public offering, pursuant to Section 3(b), 4(2) or 4(6) of the Securities Act of 1933 and the rules and regulations thereunder, provided, however, that such person shall not effect sales of municipal or government securities, or equity interests in or the debt of direct participation programs as defined in [NASD] Rule 1022(e)(2).”

and *not* required to take the new qualification examination. Instead, they would be given a period of six months during which they may “opt in” to the Limited Representative-Investment Banking registration, provided that at the time the proposed rule change is implemented, such individuals are engaged in investment banking activities covered under the proposed rule change (and the sponsoring broker-dealer’s Form BD indicates that it engages in investment banking activities). Those individuals who opt in to the Limited Representative-Investment Banking registration would not lose their Series 7 registration by making this election. After the six-month opt-in period, any individual holding a Series 7 registration who wishes to engage in the specified investment banking activities would be required to pass the Limited Representative-Investment Banking examination.

In order to further ease the transition and to allow FINRA members to create examination preparation programs, FINRA proposes to allow candidates who are in the process of becoming qualified in the Limited Representative-Investment Banking registration category when the rule becomes effective, to take either the Series 7 or Limited Representative-Investment Banking examination. This accommodation would be effective for six months after the implementation date of the proposed rule change.

For those FINRA members who have training programs in which new employees are exposed to the firm’s various business lines by rotating through departments, including an investment banking department, the proposed rule would not require such employees to register as a Limited Representative-Investment Banking for a period of up to six months from the time the employee first engages in activities that would otherwise trigger such registration. This exception would be available for up to two years after the employee begins the training program. However, firms that wish to avail themselves of this exception must maintain documents evidencing the details of the training program which identify program participants who engage in activities that would otherwise require registration and the date on which such participant began such activities.

In addition, individuals who wish to act as a general principal for activities set forth in the proposed rule would be required

to obtain the new Limited Representative-Investment Banking registration either by opting in (as described above) or passing the Limited Representative-Investment Banking examination, in addition to the General Securities Principal Examination (Series 24). Individuals currently acting as a general principal supervising investment banking activities described in the proposed rule would also be granted a six-month grace period during which they could opt in to the Limited Representative-Investment Banking registration.

The implementation date of proposed NASD Rule 1032(i) will be 90 days after the effectiveness of a future proposed rule change to establish the accompanying qualification examination. Interested parties may submit comments on proposed NASD Rule 1032(i) on or before March 31, 2009.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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