

SEC Approves FINRA Rule Proposal to Repeal NYSE Rule 312(f)

I. Introduction

On September 11, 2009, the Securities and Exchange Commission (the “SEC” or “Commission”) published a release approving changes proposed by The Financial Industry Regulatory Authority, Inc. (“FINRA”)¹ that would adopt without any material changes NASD Rules 2240 (Disclosure of Control Relationship with Issuer), 2250 (Disclosure of Participation or Interest in Primary or Secondary Distribution) and 3340 (Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts) as rules in the Consolidated FINRA Rulebook, such rules to be redesignated, respectively, as FINRA Rules 2262, 2269 and 5260.² Significantly, in connection with the redesignation of NASD Rule 2240 as new FINRA Rule 2262, the Commission also approved the repeal of existing NYSE Rule 312(f), which (like NASD Rule 2240) addresses conflict of interest issues when a NYSE member firm engages in certain activities involving the securities of an entity with which it is in a control relationship.³

The effective date of the new FINRA rules and corresponding repeal of NYSE Rule 312(f) has not yet been announced.⁴

¹ FINRA was created in July 2007 through the consolidation of the National Association of Securities Dealers, Inc. (the “NASD”) and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (the “NYSE”). FINRA is in the process of creating a consolidated rulebook consisting solely of FINRA rules. The current FINRA rulebook includes (1) FINRA Rules, (2) NASD Rules and (3) certain rules incorporated from the NYSE (“Incorporated NYSE Rules”). Although the NASD Rules generally apply to all members of FINRA, the Incorporated NYSE Rules only apply to those FINRA members that are also NYSE members.

² SEC Rel. No. 34-60659 (Sept. 11, 2009), 74 Fed. Reg. 48117 (Sept. 21, 2009) (File No. SR-FINRA-2009-044) (the “FINRA Rule Change Proposal”).

³ In connection with the FINRA Rule Change Proposal, the Commission also approved the repeal of existing NYSE Rule 321.24, given the similar (but broader) disclosure requirements of NASD Rule 2250.

⁴ The FINRA Rule Change Proposal does not impact existing paragraphs (a) through (e), (g), (h), (i) or (j) of Incorporated NYSE Rule 312. Amendment No. 1 to the FINRA Rule Change Proposal clarified that paragraph (h) of Incorporated NYSE Rule 312, which the original proposal had noted was “reserved”, would remain in place and would not be changed by the current proposal. However, Amendment No. 1 also noted that FINRA had previously submitted to the Commission a separate rule

II. NYSE Rule 312(f) and NASD Rule 2240

The provisions contained in existing NYSE Rule 312(f) were approved by the Commission on August 25, 2006. At such time, Rule 312(f) was amended (among other things) to allow a member to recommend and effect solicited transactions in securities issued by an entity in a control relationship with the member, so long as such entity was not the member's parent organization or an entity designated as a "material associated person"⁵ of the member, and so long as the member promptly disclosed to its customers the existence and nature of the control relationship at the time of the recommendation.⁶

NASD Rule 2240, the substance of which is virtually identical to Rule 15c1-5 under the Exchange Act, requires members to disclose the existence of any control relationship with the issuer of a security before entering into a contract for the purchase or sale of such security with a customer.⁷ Unlike NYSE Rule 312(f), NASD Rule 2240 is not limited to situations in which a "recommendation" is made but at the same time does not prohibit members from recommending to customers securities issued by a parent organization or "material associated person" of the member. Accordingly, NASD Rule 2240 is both broader yet less restrictive than NYSE Rule 312(f) and, historically, this difference may have provided an advantage to NASD (now FINRA) member firms that were not also members of the NYSE.

In proposing the repeal of NYSE Rule 312(f), FINRA noted (and in approving the proposed repeal, the Commission agreed) that the purposes served by that rule are addressed by proposed FINRA Rule 2262 (which would replace, without change, existing NASD Rule

change proposal that, if approved, would delete NYSE Rule 312(h). *See* Securities Exchange Act Release No. 34-59273 (Jan. 22, 2009), 74 Fed. Reg. 4992 (Jan. 28, 2009) (File No. SR-FINRA-2008-067).

⁵ *See* Rule 17h-1T(a)(2) under the Securities Exchange Act of 1934 (the "Exchange Act") for the meaning of "material associated person".

⁶ *See* SEC Release No. 34-54368 (Aug. 25, 2006), 71 Fed. Reg. 52202 (Sept. 1, 2006) (File No. SR-NYSE-2005-58). Prior to March 2006, the substance of the provisions contained in NYSE Rule 312(f) was contained in paragraph (g) of that rule. Prior to the effective date of the changes to NYSE Rule 312(f) in September 2006, the rule prohibited (after the completion of a distribution of its securities) a member corporation that has publicly held securities outstanding from (i) soliciting transactions in those securities, or (ii) making recommendations about those securities or any securities issued by any corporation "controlling, controlled by or under common control with" the member. By NYSE interpretation, the rule's application had been extended to all members affiliated with publicly held corporations, whether or not the member itself had publicly held securities.

⁷ Both NYSE Rule 312(f) and NASD Rule 2240 also require that any oral disclosure with regard to the control relationship be supplemented by written disclosure provided at or before the completion of the transaction (typically, this is accomplished by including the disclosure in the confirmation of the transaction required to be provided to customers under Exchange Act Rule 10b-10). Exchange Act Rule 15c1-5 contains the same written disclosure requirement.

2240), as well as by other existing or proposed FINRA rules and SEC rules (including, *e.g.*, FINRA Rule 2020⁸ and Exchange Act Rule 10b-5).

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⁸ FINRA Rule 2020 provides that members shall not “effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.”

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