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Structured Thoughts

News for the financial services community.

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A Summary of FWP Filing Requirements Under SEC and FINRA Rules

Introduction

In October 2010, FINRA released its Regulatory Notice 10-52. Notice 10-52, among other things, applies FINRA's filing and related requirements set forth in NASD Rule 2210 to broadly disseminated FWPs used by broker-dealers. (Our summary of the release may be found at: http://www.mofo.com/files/Uploads/Images/101026-Structured-Thoughts.pdf.)

Market participants have now been reminded of the applicability of the FINRA rules to FWPs. Because both the SEC's filing rules and FINRA's rules apply to these documents, as a brief reference guide we have prepared the following summary of their respective rules. These rules frequently come into play in connection with FWPs prepared for different types of structured products.

Summary of Filing Requirements

	SEC Rules	FINRA Rules
FWPs Required to Be Filed:	"Issuer free writing prospectuses" (as defined in Rule 433(h)). FWPs prepared by an underwriter and disseminated on a broad, unrestricted basis. Any FWP containing the "final terms" of an offering. (Source: Rule 433(d)(1))	FWPs disseminated by a broker on a broad, unrestricted basis. (Key example: a website that is not password protected.) Filing requirement covers: • Advertisements and sales literature concerning registered investment companies. • Advertisements and sales literature concerning public direct participation programs. • Advertisements concerning government securities. • Templates for written reports produced by, or advertisements and sales literature concerning, an investment analysis tool (as defined in Rule IM-2210-6). (Source: NASD Rule 2210(c)(2), (3), and (4))
Key Exclusions from Filing:	FWPs containing solely preliminary terms. (Rule 433(d)(5)(i)) FWPs that do not contain substantive changes from an FWP that was previously filed with the SEC. (Rule 433(d)(1)(3))	Advertisements and sales literature that previously have been filed and that are to be used without material change. (NASD Rule 2210(c)(8)(A))
Required Timing of Filing:	Date of first use. For "final terms FWPs," within two days of the *later of* the date such final terms have been established and the date of first use. (Source: Rule 433(d)(1), Rule 433(d)(5)(ii))	Generally, within 10 days of first use or filing. (NASD 2210(c)(2)) Sales literature concerning bond mutual funds that include or incorporate bond mutual fund volatility ratings must be filed at least 10 business days prior to use (or such shorter period as FINRA may allow in particular circumstances). (NASD Rule 2210(c)(3))
Review and Liability Issues:	Subject to Section 11 liability under the 1933 Act for misstatements.	Must be approved by a registered principal of the member. (NASD Rule 2210(b)(1)) Subject to the content standards of Rule 2210(d). (Accurate, "fair and balanced," and related requirements.)

	SEC Rules	FINRA Rules
Document Retention Requirements:	Three years after the initial offering of the securities. (Rule 433(g))	FINRA members must maintain all advertisements, sales literature, and independently prepared reprints in a separate file for a period beginning on the date of first use and ending three years from the date of last use. (NASD Rule 2210(b)(2))

Please note that, as per its September 2009 proposals to amend NASD Rule 2210, FINRA's filing requirements, particularly as to structured products, are subject to change.[1] We intend to issue a client alert in the event of any material developments in this area.

[1] The rules proposed in September 2009 may be found at: http://www.finra.org/web/groups/arbitrationmediation/documents/industry/p120006.pdf.

SEC Proposes to Extend Effectiveness of Rule 206(3)-3T

In December 2010, the SEC proposed to extend the sunset provision of Rule 206(3)-3T.[1] The rule is currently scheduled to expire on December 31, 2010. However, if so extended, the rule will expire on December 31, 2012.

Rule 206(3)-3T had initially been adopted as an interim rule by the SEC in 2007 in order to provide an alternative means for investment advisers registered as broker-dealers to satisfy the requirements of Section 206(3) of the Advisers Act of 1940 ("Advisers Act") when they act in a principal capacity in transactions with certain of their advisory clients. We previously discussed the rule in our January 12, 2010 edition of "Structured Thoughts,"[2] and have included below a summary of the rule.

In proposing the extension, the SEC noted that, under the 2010 Dodd-Frank Act, it was required to complete a study and report as to the obligations of broker-dealers and investment advisers, including their respective standards of care. The results of this effort could impact applicable regulations. However, because the results will not be ready until after the current expiration date, and because any new regulations could take some time to draft and adopt, the SEC determined that it was appropriate to extend the temporary rule.

As a key feature of its determination, the SEC noted that in connection with its examination of brokers' activities under the rule, the SEC did not identify any cases of "dumping" securities into accounts covered by the rule. (However, the SEC did note that it had encountered a variety of compliance issues of concern,[3] and was taking a variety of actions to address them, including referrals to its Division of Enforcement.)

A short comment period for the proposal will end on December 20, 2010. Industry participants may seek to use the comment period to address a number of issues with respect to the temporary rule. For example, in the past, the SEC expressed its belief that broker-dealers did not rely to a significant extent on the rule[4] – industry participants that do in fact utilize the rule may wish to make this fact known to the SEC staff, and state that accordingly, the sunset should be delayed. In addition, the temporary rule is not currently available for use in connection with sales of structured products. The comment period may be used by industry participants to articulate whether and to what extent the rule could be extended to these types of offerings. In doing so, broker-dealers could address the SEC's potential questions as to whether these offerings have any greater risk of "dumping" than the other types of offerings that are permitted under the rule.[5]

Background

Under Section 206(3) of the Advisers Act, an investment adviser acting as principal for its own account cannot (1) sell any security to, or purchase any security from, a client; or (2) act as a broker-dealer for a person other than the client, effect any sale or purchase of any security for the account of the client, without (a) disclosing to the client in writing, prior to the completion of the transaction, the capacity in which it is

[1] The proposing release may be found at: http://www.sec.gov/rules/proposed/2010/ia-3118.pdf.
[2] Available at: http://www.mofo.com/files/Publication/d3eca515-40a4-4991-adfc-780d3a840532/Presentation/PublicationAttachment/5cab055d-f9d3-4a08-9bfe-d1cf7e9ec618/100112Structured_thoughts_newsletter_vol_1.pdf.
[3] See pages 7-8 of the proposing release.
[4] See, for example, the letter from Andrew J. Donohue of the SEC to the Securities Industry and Financial Markets Association, dated August 9, 2010, indicating that the SEC's Division of Investment Management would not recommend further SEC action on the rule. The letter may be found at: http://www.sec.gov/rules/final/2009/ia-2965a-sifma-letter.pdf.
[5] The SEC requested comment on this question in its 2007 adopting release, Release No. IA-2653 (http://www.sec.gov/rules/final/2007/ia-2653.pdf).

acting, and (b) obtaining the client's consent for the transaction, unless the investment adviser is not acting as such in connection with the transaction.

The SEC adopted Rule 206(3)-3T in order to provide limited relief to investment advisers that are dually registered as broker-dealers ("Dual Registrants") from the principal trading restriction under Section 206(3). The rule enables fee-based brokerage customers to convert their accounts to fee-based accounts subject to the Advisers Act or to commission-based brokerage accounts.

Background of Rule 206(3)-3T

Under Section 206(3) of the Advisers Act, Dual Registrants must provide written notice and obtain client consent on a transaction-by-transaction basis when trading as a principal with a client. Rule 206(3)-3T provides Dual Registrants with an alternative means to comply with Section 206(3), while still requiring transaction-by-transaction disclosure. Specifically, the Rule permits a Dual Registrant to engage in principal transactions with a non-discretionary advisory client, subject to the following conditions:

- *Blanket Written Notice and Revocable Consent*. The Rule requires the Dual Registrant to provide the client with a blanket written prospective notice and obtain the client's blanket written revocable prospective consent with respect to principal transactions.
- *Eligible Securities*. The Rule applies to any principal trade that does not involve (1) a security issued by the Dual Registrant (or by an affiliate of the Dual Registrant) or (2) a transaction in which the Dual Registrant (or an affiliate of the Dual Registrant) acts as underwriter, other than offerings of non-convertible investment grade debt securities.[6]
- *Trade-by-Trade Disclosure/Client Consent*. The Rule requires that the Dual Registrant, prior to the completion of each principal transaction, (1) inform the client that the Dual Registrant is acting as principal for its own account with respect to the transaction and (2) obtain the consent from the client for the transaction. The trade-by-trade disclosure and consent may be written or oral.
- *Confirmation Disclosure*. The Rule requires that the confirmation provided to the client under Rule 10b-10 of the Exchange Act, at or before completion of the transaction, indicate in Plain English that (1) the Dual Registrant disclosed to the client prior to the execution of the transaction that it may act in a principal capacity in connection with the transaction, (2) the client authorized the transaction, and (3) the Dual Registrant sold the security to or purchased the security from the client for its own account.
- *Annual Report*. The Rule requires that the Dual Registrant provide the client with a list of all principal trades that were executed in the client's account during the prior year, including the date and price of the transactions.

Investment advisers that trade in securities issued by, or underwritten by, affiliates should be mindful that these securities are not eligible securities (as discussed above) and therefore, the investment adviser must obtain consent for each transaction on a trade-by-trade basis. The Rule does not relieve any investment adviser of its fiduciary obligations under the Advisers Act or other applicable provisions of federal law. The SEC will continue to study how the rule is being used in connection with its work under the Dodd-Frank Act.

[6] As noted above, the exemption for non-convertible investment grade debt securities underwritten by an affiliated broker-dealer does not extend to structured products that are investment grade debt. Thus, for principal trades in structured products underwritten by an affiliate, the investment adviser must obtain consent on a trade-by-trade basis.

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