Research Black-Out Restrictions for Initial and Secondary Offerings By FINRA Member Firms Under NASD Rule 2711

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The following is a discussion of the research “black-out” restrictions under NASD Rule 2711 in connection with an initial or secondary offering of securities by a FINRA member firm.

Restrictions on the Distribution of Research Under NASD Rule 2711

NASD Rule 2711(f) prohibits a FINRA member from distributing research regarding an issuer if the member is acting as an underwriter or dealer with respect to an initial public offering (“IPO”) or a secondary offering by the issuer, subject to certain exceptions. The same rule also restricts a research analyst associated with the member from making a public appearance with regard to the issuer’s securities.

(1) Initial Public Offerings – A FINRA member firm acting as a manager or co-manager of an IPO is prohibited from publishing or distributing research or making a public appearance regarding the issuer for 40 calendar days following the date of the offering. A member firm participating as an underwriter or dealer of an IPO in a capacity other than as a manager or co-manager is prohibited from publishing research or making a public appearance regarding the issuer for 25 calendar days after the date of the offering.

(2) Secondary Offerings – A member firm acting as a manager or co-manager of a secondary offering or is prohibited from publishing or distributing research or making a public appearance regarding the issuer for ten calendar days following the date of the offering.

For purposes of the 40, 25 and ten-day restrictions noted above, the relevant offering date is the later of the effective date of the U.S. registration statement, if any, or the first date the securities are bona fide offered to the public. The latter term refers to the date the securities are actually offered to the public, as opposed to an earlier date on which the offering might have commenced in the technical sense (e.g., the effective date of a registration statement or the date on which offers were made to only a limited number of prospective investors).

Exception for Significant News or Events

The black-out restrictions do not prevent the member firm from publishing research or a research analyst from making a public appearance concerning the effects of “significant news or a significant event”

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1 Prior to the merger of the National Association of Securities Dealers (“NASD”) and the New York Stock Exchange, each organization had its own rules. The merged entity, the Financial Industry Regulatory Authority (“FINRA”), is in the process of consolidating the NASD and NYSE rulebooks. Until the consolidation is completed, certain of the FINRA rules that have not yet been converted, including Rule 2711, continue to be referred to as “NASD Rules.”
regarding the issuer, provided that the publication or appearance is approved beforehand by the firm’s legal or compliance personnel. In accordance with FINRA guidance provided in Notice to Members 02-39 (July 2002), “significant news or significant event” refers to any news or event that would have a “material impact on, or that is expected to cause a material change to, the subject company’s operations, earnings or financial condition.” The exception generally permits research on extraordinary news or events that would ordinarily trigger the filing of Form 8-K by the issuer with respect to the information, such as the rejection of a patent or drug application, a labor strike, resignation of a chief executive officer or chief financial officer, or a publicly-announced investigation into company activities by a regulator. Events within the issuer’s control, such as the offering of securities to investors, generally would not be significant; however, an extraordinary market occurrence, internal condition or other event necessitating the offering might be. A routine earnings announcement by the issuer would not be considered significant news or a significant event notwithstanding the filing of an 8-K with respect to the announcement, unless the occasion is used to relate other information of an extraordinary nature. See Notice to Members 04-18 (March 2004).2

Exception for Qualified Research in Connection with a Secondary Offering

Another exception exists to the ten-day black-out period with respect to secondary offerings permits member firms to publish research pursuant to Rule 139 under the Securities Act of 1933, as amended (the “Securities Act”), concerning issuers with “actively traded securities” (as defined in Regulation M), and to follow for public appearances by research analysts concerning such issuers.

1. Actively Traded Securities – A company’s securities are considered “actively-traded” under Regulation M if the securities have a worldwide average daily trading volume of at least U.S. $1 million and are issued by an issuer whose common equity securities have a public float value of at least U.S. $150 million (provided that the securities are not issued by the distribution participant or an affiliate).3

2. SEC Rule 139 – NASD Rule 2711(f)(1)(B) incorporates Rule 139 by reference to permit the publication of issuer specific research reports and industry reports on qualified issuers if the research is distributed in the regular course of business and certain other conditions are met.4

   (a) Issuer Specific Research Reports (Rule 139(a)(1)) – In order to qualify for the exception for issuer specific reports, the issuer must be a qualified U.S. reporting company or foreign private issuer. A U.S. reporting company must meet the registration requirements of Form S-3 or F-3 and either: (i) the issuer must meet the minimum float requirements of such forms (currently, U.S. $75 million) or; (ii) the offering must meet the requirements for the offering of non-convertible investment grade securities pursuant to General Instruction I.B.2 of Form S-3 or Form F-3;5 or (iii) the issuer must be a “well-known seasoned issuer” as defined in Rule 405 under the Securities Act (generally an issuer with U.S. $700

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2 Rule 2711(f)(1) as currently written does not expressly permit member firms participating in an IPO in a non-management capacity to take advantage of the “significant news or significant event” exception to the prohibition on the publication of research during the twenty-five-day black-out period, although there is no obvious reason why the exception should not apply in this context just as it does for firms acting as managers or co-managers of IPOs. Until FINRA provides guidance stating otherwise, firms participating in IPOs in a non-management capacity might be advised to seek specific approval from FINRA before publishing research or making public appearances concerning the issuer during the twenty-five-day black-out period where relying on the significant news or events exception.

3 The phrase “common equity securities” includes the equivalent type of stock of a foreign issuer for purposes of the calculation of average daily trading volume. See Frequently Asked Questions About Regulation M, Division of Market Regulation: Staff Legal Bulletin No. 9; Revised September 10, 2010.

4 Under Rule 139, certain research is deemed not to constitute an “offer” to sell securities subject to a distribution for purposes of the prospectus delivery requirements under Section 5 of the Securities Act.

5 A non-convertible security is an “investment grade security” if, at the time of sale, at least one nationally recognized statistical rating organization (as that term is used in Rule 15c3-1(c)(2)(vi)(F) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) has rated the security in one of its generic rating categories that signifies investment grade; typically, the four highest rating categories (within which there may be subcategories or gradations indicating relative standing) signify investment grade. See General Instruction I.B.2 of Form S-3 or Form F-3.
The company must have filed all periodic reports required during the preceding 12 months on Forms 10-K, 10Q and 20-F. Alternatively, the subject company must be a foreign private issuer\(^7\) that meets all of the registration requirements of Form F-3 (other than the reporting history provisions)\(^8\) and either (i) satisfies the U.S. $75 million public float threshold of Form F-3, or (ii) is issuing non-convertible investment grade securities under General Instruction I.B.2 of Form F-3. In addition, the foreign private issuer must either (i) have its equity securities trading on a designated offshore securities market as defined in Rule 902(b) under the Securities Act,\(^9\) or (ii) have a worldwide market value of its outstanding common equity held by non-affiliates of U.S. $700 million or more.

In addition, the publication or distribution of the report may not represent the initiation or re-initiation of coverage of the issuer. Therefore, there must be at least one previous report on the subject company (or one report in resumption of coverage). However, the previous research report does not have to have covered the same securities that are the subject of the registered offering.

(b) Industry Reports (Rule 139(a)(2)) – In order to qualify for the exception for industry reports, the issuer must be a reporting company pursuant to Section 13 or Section 15(d) of the Exchange Act\(^10\) or a foreign private issuer meeting the conditions described above. In addition, the report must contain similar information on a substantial number of issuers in the industry (or contain a list of securities currently recommended by the firm) and the analysis on the issuer subject to distribution must have no greater prominence in the report than that given to other issuers. The firm must publish or distribute research in the regular course of its business and, at the time of publication of the industry report, must be including similar material about the issuer or its securities in similar reports.

For both issuer specific research reports and industry reports, the issuer may not be, and it or its predecessors may not have been over the previous three years, (1) a blank check company,\(^11\) (2) a shell...

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6. To qualify as a well-known seasoned issuer, the issuer must have either U.S. $700 million of worldwide public common equity float or have issued U.S. $1 billion of non-convertible securities, other than common equity, in registered offerings for cash, in the preceding three years, among other requirements. See Rule 405 under the Securities Act.

7. A foreign private issuer is defined in Rule 3b-4 under the Exchange Act as any foreign issuer other than a foreign government, except any issuer that (1) has more than 50 percent of the its outstanding voting securities directly or indirectly owned by residents of the United States; and (2) either (a) the majority of its executive officers or directors are United States citizens or residents; or (b) more than 50 percent of its assets are located in the United States; or (c) its business is administered principally in the United States.

8. The conditions for filing a Form F-3 registration statement include: (1) filing in a timely manner all reports required to be filed in the year (and any portion of a month) immediately preceding the filing of the registration statement; (2) neither the registrant nor any of its consolidated or unconsolidated subsidiaries have, since the end of their last fiscal year for which certified financial statements of the registrant and its consolidated subsidiaries were included in a report filed pursuant to Section 13(a) or 15(d) of the Exchange Act: (a) failed to pay any dividend or sinking fund installment on preferred stock; or (b) defaulted (i) on any installment or installments on indebtedness for borrowed money, or (ii) on any rental on one or more long term leases, which defaults in the aggregate are material to the financial position of the registrant and its consolidated subsidiaries, taken as a whole; (3) if the registrant is a successor registrant, it shall be deemed to have met conditions (1) and (2) above if: (a) its predecessor and it, taken together, do so, provided that the succession was primarily for the purpose of changing the state or other jurisdiction of incorporation of the predecessor or forming a holding company and that the assets and liabilities of the successor at the time of succession were substantially the same as those of the predecessor; or (b) all predecessors met the conditions at the time of succession and the registrant has continued to do so since the succession. See General Instructions I.A.2-4 of Form F-3.

9. “Designated offshore securities market” under Rule 902(b) includes: the Eurobond market, as regulated by the International Securities Market Association; the Alberta Stock Exchange; the Amsterdam Stock Exchange; the Australian Stock Exchange Limited; the Bermuda Stock Exchange; the Bourse de Bruxelles; the Copenhagen Stock Exchange; the European Association of Securities Dealers Automated Quotation; the Frankfurt Stock Exchange; the Helsinki Stock Exchange; The Stock Exchange of Hong Kong Limited; the Irish Stock Exchange; the Istanbul Stock Exchange; the Johannesburg Stock Exchange; the London Stock Exchange; the Bourse de Luxembourg; the Mexico Stock Exchange; the Borsa Valorì di Milan; the Montreal Stock Exchange; the Oslo Stock Exchange; the Bourse de Paris; the Stock Exchange of Singapore Ltd.; the Stockholm Stock Exchange; the Tokyo Stock Exchange; the Toronto Stock Exchange; the Vancouver Stock Exchange; the Warsaw Stock Exchange and the Zurich Stock Exchange; and any foreign securities exchange or non-exchange market designated by the Commission.

10. There is no requirement that the reporting company meet any public float or investment grade issue test as there is for issuer specific reports.

11. The term “blank check company” is defined in Rule 419(a)(2) under the Securities Act (17 C.F.R. § 230.419(a)(2)) as a company that: (1) is a development stage company that has no specific business plan or purpose or has indicated that its business plan is to...
company\textsuperscript{12} (other than a business combination related shell company) or (3) an issuer for an offering of penny stock.\textsuperscript{13}

**Black Out Restrictions with regard to Lock-Ups**

A member firm acting as manager or co-manager of an initial or secondary offering is prohibited from publishing or distributing a research report or making a public appearance concerning the subject company 15 days prior to the and after the expiration, waiver or termination of a lock-up agreement or other agreement the member has entered into with the company or a shareholder prohibiting or restricting the sale of securities held by the company or shareholder upon completion of the offering.

The foregoing restriction does not apply to distribution of research concerning significant news or events (subject to approval by the firm’s legal or compliance department) or the publication of research in compliance with Rule 139 for actively traded securities, discussed above.

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Please contact us if you have any questions or would like more information on the material discussed in this memorandum.