

Baker Donelson Alert: FINRA Issues Guidance to Broker-Dealers and Issuers Regarding Unregistered Resales of Restricted Securities

January 23, 2009

Earlier this month, Financial Industry Regulatory Authority (FINRA) issued guidance in Notice to Members 09-05 (the Notice) to broker-dealers handling unregistered resales of restricted securities. In summary, broker-dealers must have procedures reasonably designed to avoid becoming participants in an unregistered distribution of securities. Likewise, issuers and holders of restricted securities should take particular note of the guidance FINRA provided with respect to the operational mechanics of how broker-dealers must perform due diligence regarding reliance on opinions of counsel, clearing firms and transfer agents.

The Notice stated the Securities Exchange Commission (SEC) has said in the past it is not sufficient for a broker-dealer to "accept self-serving statements of sellers and their counsel without reasonably exploring the possibility of contrary facts." As such, FINRA has recommended that broker-dealers institute the following three-step procedure to review unregistered resales of restricted securities:

- An initial review of how, when and under what circumstances a customer obtained the securities to be sold, including review of (a) registration statements, (b) the float of the stock, (c) the amount of stock under the control of the customer and (d) how much stock has been sold by the customer in the past. FINRA recommends that this information be memorialized in questionnaire form.
- Formal review by a principal of the broker-dealer of (a) the customer's background, (b) the conditions under which the securities may be resold, (c) the status of registration statements for the company and (d) the authenticity of stock certificates.
- While FINRA notes that an opinion of counsel is to be part of the review by the broker-dealer's principal, such an opinion alone cannot be relied upon in making a final determination as to whether to process the sale of the subject securities. Broker-dealers should note that active trading status of the subject security with a clearing firm does not necessarily mean that the security may be resold immediately without limitation.

Issuers and holders of restricted securities should be prepared to provide detailed information to assist broker-dealers in their review of resales of restricted securities. Accordingly, those who wish to engage in the resale of restricted securities should account for both the information and time needed by broker-dealers to review prospective transactions.