

INFORMATIONAL

**SEC Rule 504
And Intra-State-
Only Offerings**

**Amendments Adopted To
Clarify The Application Of
NASD Rules To Offerings
Under SEC Rule 504 And
Intra-State-Only Offerings****SUGGESTED ROUTING**

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Corporate Finance
- Legal & Compliance
- Trading & Market Making

KEY TOPICS

- Free-Riding and Withholding
- IM-2110-1
- NASD Rule 2710
- NASD Rule 2720
- NASD Rule 2810
- Underwriting Compensation

Executive Summary

On December 1, 1999, the Securities and Exchange Commission (SEC) approved amendments submitted by NASD Regulation, Inc. (NASD RegulationSM) that clarify the application of certain National Association of Securities Dealers, Inc. (NASD[®]) rules to limited offerings under SEC Rule 504 and intra-state-only offerings.¹

The text of these amendments is included with this *Notice to Members* (see Attachment A).

Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Suzanne E. Rothwell, Chief Counsel, Corporate Financing Department, NASD Regulation, at (202) 974-2700.

Discussion

SEC Rule 504 provides an exemption from registration under Section 5 of the Securities Act of 1933 (Securities Act) for offerings of up to \$1 million of securities. The SEC amended Rule 504 in early 1999² to provide that securities sold under Rule 504 will be deemed “restricted securities” under SEC Rule 144, and general solicitation and advertising will be prohibited unless the offering is:

- (1) registered in at least one state that requires public filing and delivery of a disclosure document before sale; or
- (2) offered exclusively in states that provide exemptions from registration and permit general solicitation and advertising, but that require that sales be made only to “accredited investors.”

Securities deemed to be “restricted securities” under SEC Rule 144 may only be sold into the public market in compliance with the holding period, manner of sale, and volume restrictions of that rule.

The NASD has amended its rules to clarify that Rule 504 offerings that are public offerings of unrestricted securities are required to be filed with NASD Regulation for review of underwriting terms and arrangements under NASD Rules 2710 and 2810, and compliance with the requirements of NASD Rule 2720.³

Description Of Amendments**Rule 504 Offerings**

NASD Regulation has amended its rules to provide that all Rule 504 offerings, other than offerings of securities that would be deemed “restricted securities” under SEC Rule 144, must be filed with NASD Regulation for review and are subject to compliance with the requirements in Rules 2710, 2720, or 2810, as applicable.⁴ Rule 504 offerings are not required to be filed with NASD Regulation if the securities are deemed “restricted securities” under SEC Rule 144. This amendment is consistent with the application of Rules 2710, 2720, and 2810 to other offerings that are exempt from SEC registration but are nonetheless public in nature.

In addition, IM-2110-1 has been amended to apply the Free-Riding and Withholding Interpretation to offerings of securities under Rule 504 that are not deemed “restricted securities” under SEC Rule 144.

Intra-State-Only Offerings

Rule 2710(b)(9) has also been amended to delete rule language stating that an offering relying on

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Section 3(a)(11) of the Securities Act (the SEC's intra-state-only offering exemption) must be filed only when the offering is "considered a public offering in the state where offered." Consequently, all intra-state-only securities offerings must be filed with NASD Regulation for review and are subject to compliance with Rules 2710, 2720, and 2810, as applicable.

Members' Filing Obligations

Some members have questioned whether Rule 504 offerings and intra-state-only offerings must be

filed with NASD Regulation when NASD members have not distributed securities in the offering. The definition of "participation in a public offering" in Rule 2710(b)(5), however, includes a wide group of activities by a member in connection with an offering in addition to distribution activities. Such additional activities include:

- participation in the preparation of the offering or other documents;
- furnishing of customer and/or broker lists for solicitation; or

- participation in any advisory or consulting capacity to the issuer.

Members are reminded of their obligation to file any public offering with NASD Regulation when they will participate in a public offering as set forth in Rule 2710.

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ATTACHMENT A

Text Of Amendments

(Note: New text is underlined; deletions are in brackets.)

IM-2110-1. "Free-Riding and Withholding"

(I) Explanation of Terms

The following explanation of terms is provided for the assistance of members. Other words which are defined in the By-Laws and Rules shall, unless the context otherwise requires, have the meaning as defined therein.

(1) Public Offering

The term public offering shall mean any primary or secondary distribution of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition, straight debt offerings, offerings pursuant to SEC Rule 504, and all other securities distributions of any kind whatsoever, except any offering made pursuant to an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act of 1933, as amended, or pursuant to Rule 504 if the securities are "restricted securities" under SEC Rule 144(a)(3) [(unless considered a public offering in the states where offered)], Rule 505, or Rule 506 adopted under the Securities Act of 1933, as amended. The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Act, and debt securities (other than debt securities convertible into common or preferred stock) and financing instrument-backed securities that are rated by a

nationally recognized statistical rating organization in one of its four highest generic rating categories. The term public offering shall exclude secondary offerings by an issuer, or any security holder of the issuer, of actively-traded securities.

2710. Corporate Financing Rule - Underwriting Terms and Arrangements

(a) No change.

(b) Filing Requirements

(1) - (7) No change.

(8) Exempt Offerings

Notwithstanding the provisions of subparagraph (1) above, the following offerings are exempt from this Rule, Rule 2720, and Rule 2810. Documents and information relating to the following offerings need not be filed for review:

(A) securities exempt from registration with the Commission pursuant to the provisions of Sections 4(1), 4(2), or 4(6) of the Securities Act of 1933, as amended, or pursuant to Rule 504 [(unless considered a public offering in the states where offered)] if the securities are "restricted securities" under SEC Rule 144(a)(3), Rule 505, or Rule 506 adopted under the Securities Act of 1933, as amended;

* * *

(9) Offerings Required to be Filed

Documents and information relating to all other public offerings including, but not limited to, the following must be filed with the Association for review:

(A) - (C) No change.

(D) securities exempt from registration with the Commission pursuant to Section 3(a)(11) of the Securities Act of 1933, as amended[, which is considered a public offering in the state where offered];

(E) securities exempt from registration with the Commission pursuant to Rule 504 adopted under the Securities Act of 1933, as amended, [which is considered a public offering in the states where offered] unless the securities are "restricted securities" under SEC Rule 144(a)(3);

2720. Distribution of Securities of Members and Affiliates — Conflicts of Interest

(a) General No change.

(b) Definitions

For purposes of this Rule, the following words shall have the stated meanings:

(1) - (13) No change.

(14) Public offering — any primary or secondary distribution of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition, straight debt offerings, offerings pursuant to SEC Rule 504, and all other securities distributions of any kind whatsoever, except any offering made pursuant to an exemption from registration under Sections 4(1), 4(2), or 4(6) of the Securities Act of 1933, as amended, or pursuant to SEC Rule 504 [(unless considered a public

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offering in the states where offered)] if the securities are "restricted securities" under SEC Rule 144(a)(3), SEC Rule 505, or SEC Rule 506 adopted under the Securities Act of 1933, as amended. The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Act.

Endnotes

¹Securities Act Release No. 42191 (December 1, 1999); 64 FR 68404 (December 7, 1999).

²Securities Act Release No. 7644 (February 25, 1999), 64 FR 11090 (March 8, 1999).

³The definition of "public offering" found in Rule 2720 determines which offerings are subject to that rule and must be filed with NASD Regulation for pre-offering review under Rules 2710 and 2810. Rule 2710 explicitly incorporates the definitions contained in Rule 2720. See Rule 2710(a). The definition of the term "public offering" included in the Free-Riding and Withholding Interpretation, Rule IM-2110-1, is limited to the application of that Interpretation. See Endnote 1 in *NASD Notice to Members 98-48* (July 1998).

⁴In addition, other provisions of NASD rules that refer to "public offerings" would be interpreted to include Rule 504 offerings, except for Rule 504 offerings of securities that would be deemed to be Section 144(a)(3) "restricted securities." See NASD

Rules 0120(h) (general definition of "fixed price offering"), 0120(p) (general definition of "selling group"), 0120(q) (general definition of "selling syndicate"), 2750 (transactions with related persons), 2830 (investment company securities), 3350 (short sale rule), 3370 (prompt receipt and delivery of securities) and 6410(e) (definition of "initial public offering" in NASD systems and programs rules). As a matter of policy, the NASD interprets those provisions in the context of Rule 2720's definition of "public offering."