

## Amendments to FINRA New Issue Rules 5130 and 5131 Effective January 1, 2020

January 9, 2020

### KEY POINTS

- Amendments to FINRA Rules 5130 and 5131, which govern the offer and sale of “New Issue” securities went into effect on January 1.
- FINRA Rule 5130 prohibits a broker-dealer from selling New Issues to accounts in which “Restricted Persons” have a beneficial interest.
- FINRA Rule 5131 restricts broker-dealers from selling New Issues to accounts that are beneficially owned by persons that are executive officers or directors of public companies and certain covered non-public companies having specified relationships with the broker-dealer, and persons materially supported by these persons.
- Private fund managers and broker-dealers should update their relevant forms, certifications, and policies and procedures to reflect these changes.

On November 5, 2019, the SEC approved amendments to FINRA Rules 5130 and 5131, which govern the offer and sale of “New Issue” securities (the “Rules”). (Under the Rules, “New Issue” means any initial public offering (IPO) of an equity security as defined in Section 3(a)(11) of the Securities Exchange Act of 1934 made pursuant to a registration statement or offering circular, subject to certain exceptions.) These amendments went into effect on January 1, 2020. In general, the amendments to the Rules broaden the categories of investors that are exempt from the Rules’ restrictions. Therefore, additional types of investors may now be able to invest in New Issues directly and through their investments in private investment funds.

Private fund managers and broker-dealers should update their relevant forms, certifications, and policies and procedures to reflect these changes, some of which are summarized below.

### Background

FINRA Rule 5130 prohibits a broker-dealer from selling New Issues to accounts in which “Restricted Persons” have a beneficial interest. The term “Restricted Person” includes broker-dealers and their personnel, finders and fiduciaries in securities offerings, portfolio managers, persons owning a broker-dealer, and, in some cases, persons materially supported by, or the immediate family members of these persons. FINRA Rule 5131 restricts broker-dealers from selling New Issues to accounts that are beneficially owned by persons that are executive officers or directors of public companies and certain covered non-public companies having specified relationships with the broker-dealer, and persons materially supported by these persons.

## Summary of Significant Changes

The amendments include the following changes:

- **New general exemption for US and foreign employee retirement plans.** ERISA retirement plans that are not sponsored solely by a broker-dealer are generally exempt from the Rules 5130 and 5131. However, foreign employee retirement benefits plans and certain US retirement plans do not qualify for this exemption. The amendments to the Rules add a general exemption for any US and foreign employee retirement plan that: 1) has at least 10,000 participants and beneficiaries and \$10 billion in assets; 2) permits employees regardless of income or position to participate; 3) is administered by trustees and managers that have a fiduciary obligation to administer the funds in the best interests of the participants; and 4) is not sponsored by a broker-dealer.
- **Foreign investment companies.** Under Rule 5130, an investment company organized under the laws of a foreign jurisdiction is exempt if 1) it is listed on a foreign exchange for sale to the public; and 2) no person owning more than 5 percent of the foreign investment company is a Restricted Person. The amendments add two alternative tests for the 5 percent Restricted Person threshold, as follows: 1) the non-US investment company has 100 or more direct investors; or 2) the non-US investment company has 1,000 or more indirect investors. This exemption covers only foreign investment companies that were not formed for the specific purpose of permitting Restricted Persons to invest in new issues.
- **Sovereign entity exemption.** The definition of “Restricted Person” under Rule 5130 includes, among others, certain direct and indirect owners of a broker-dealer. The amendments exclude “sovereign entities” from the scope of owners of a broker-dealer that is restricted under Rule 5130. Therefore, a sovereign wealth fund would now be permitted to invest in New Issue securities regardless of its direct or indirect ownership of a broker-dealer. “Sovereign entities” are generally defined as a sovereign nation, (or its political subdivisions, agencies or instrumentalities), or a pool of capital or an investment fund or other vehicle owned or controlled by a sovereign nation and created for the purpose of making investments on behalf or for the benefit of the sovereign nation.
- **Exclusion for foreign offerings.** The amended Rules exclude from the definition of “New Issue” securities offshore offerings made pursuant to Regulation S under the Securities Act of 1933 (as well as other offerings made outside of the United States), unless the securities offered and sold under Regulation S or in another form of offshore offering are made as part of an offering that is also registered in the United States as part of a concurrent IPO of an equity security in the United States.
- **SPACs.** Currently, FINRA Rule 5130 excludes from the definition of “New Issue” the offerings of business development companies, direct participant programs and real estate investment trusts. The amendments add a new exclusion from the definition of “New Issue” for initial public offerings of special purpose acquisition companies (SPACs).
- **Issuer directed securities.** The amended Rules allow one or more affiliates and selling shareholders to direct allocations of securities in compliance with the other conditions of the Rules.
- **Charitable organizations.** Due to their size, some charitable organizations met the definition of a covered non-public company for purposes of FINRA Rule 5131. Therefore, executive officers or directors of these organizations were subject to that Rule’s prohibitions. Rule 5131 was amended to exclude from “covered non-public companies” those charitable organizations that would otherwise, based on asset size, fall within the definition of “covered non-public company.” This exclusion is limited to 501(c)(3) organizations.
- **Family offices and family investment vehicles.** The definition of “Restricted Persons” in FINRA Rule 5130 includes “portfolio managers,” but not portfolio managers that are advisers to family investment vehicles. A “portfolio manager” is defined as any person (or certain of their immediate family members) who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor or collective investment account. The Rule amendments align the definition

of family investment vehicles with the concept of family offices set forth in the Investment Advisers Act of 1940 and, thereby, expand the definition of family investment vehicles. Advisers to these family investment vehicles are no longer considered “portfolio managers” for purposes of Rule 5130 and, therefore, are no longer Restricted Persons.

## What Should Private Funds, Managers and Broker-Dealers Do Now?

Firm should revise their new issues questionnaires and related documentation, as necessary, to reflect the changes to the Rules that became effective January 1.

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### CONTACTS

For more information, contact your Katten attorney or any of the following [Financial Markets and Funds](#) attorneys if you have any questions:



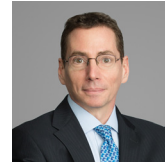
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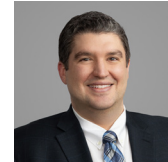
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