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### **FINRA Rule 2290: Required Disclosures in Fairness Opinions**

Under new FINRA Rule 2290, fairness opinions rendered by a FINRA<sup>1</sup> member firm where the member firm knows or has reason to know that the fairness opinion will be provided or described to a company's public shareholders must include the disclosure required by the new Rule. The required disclosures are, for the most part, of the sort which are already generally included either in fairness opinions rendered to public companies, or are included in proxy statements describing such opinions (or both). However, there are several required disclosures which are not typically made in fairness opinions themselves as a matter of current practice and therefore member firms should review their forms for such opinions to make sure that all of the disclosures required by the Rule are included. In addition to the disclosure requirements, the Rule requires members to adopt written procedures to be followed when issuing fairness opinions.

The new Rule, originally proposed in June 2005 by the NASD (now subsumed in FINRA), was approved by the Securities and Exchange Commission (the "Commission") on October 11, 2007 without the customary 30-day notice period and is therefore presently in effect. A summary of Rule 2290 follows.<sup>2</sup>

#### **I. Disclosures Required in Fairness Opinions to be Provided or Described to a Company's Public Shareholders**

Under Rule 2290, when a member firm of FINRA issues a fairness opinion which the member firm knows or has reason to know at the time the opinion is issued to a company's board of directors will be "provided or described to the company's public shareholders," the member firm must disclose in the fairness opinion, the following:

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<sup>1</sup> The Financial Industry Regulatory Authority, or FINRA, combined the NASD and the regulatory arm of the New York Stock Exchange effective July 30, 2007. All registered broker-dealers which had been members of the NASD automatically became members of FINRA.

<sup>2</sup> Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Notice of Filing of Amendment No. 4 and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment Nos. 1, 2, 3 and 4 Relating to Fairness Opinions, Rel. No. 34-56645, File No. SR-NASD-2005-080 (Oct. 11, 2007), *available at* <http://www.sec.gov/rules/sro/nasd/2007/34-56645.pdf> (hereinafter, the "SEC Approval Release"); also see, FINRA Rule 2290, Amendment No. 4, File No. SR 2005-080 (June 7, 2007), *available at* [http://www.finra.org/web/groups/rules\\_regs/documents/rule\\_filing/p019261.pdf](http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p019261.pdf) for the NASD's discussion of the Rule and its rationale therefor (hereinafter the "NASD Proposal").

- whether the member firm will receive compensation that is contingent upon the successful completion of the transaction, Rule 2290(a)(1).
- whether the member firm will receive any other “significant” payment or compensation contingent upon the successful completion of the transaction, Rule 2290(a)(2).<sup>3,4</sup>
- all material relationships that existed during the past two years in which compensation was received as a result of the relationship between the member and any party to the transaction that is the subject of the fairness opinion. In addition, any material relationships that are contemplated in which compensation is intended to be received as a result of the relationship between the member and any party to the current transaction must be disclosed. Each material relationship must be separately identified in the fairness opinion, Rule 2290(a)(3).
- whether any information that formed a substantial basis for the fairness opinion that was supplied to the member by the client has been independently verified by the member. If such information has been verified, the firm must include a description of the information or categories of information in its fairness opinion, Rule 2290(a)(4).
- whether the fairness opinion was approved or issued by a fairness committee, Rule 2290(a)(5).
- whether the fairness opinion expresses an opinion regarding the fairness of the amount of compensation from the transaction underlying the fairness opinion, to the client’s officers, directors or employees, relative to the compensation to the public shareholders of the client, Rule 2290(a)(6). This requirement does not require a member firm to evaluate any such compensation requirements. Rather, what is required is for the member to state whether the member did or did not take into account the amount and nature of compensation flowing to certain insiders relative to the benefits to shareholders in reaching a fairness determination.<sup>5</sup>

## **II. Adoption of Written Procedures for Issuing Fairness Opinions**

Rule 2290(b)(1) requires that a member issuing a fairness opinion must have written procedures for approval of its fairness opinions, including the type of transactions in which a member will use a fairness committee to approve a fairness opinion. With respect to fairness opinion committee procedures, the member must also include:

- 1) the method for selecting the committee;
- 2) the qualifications needed to sit on the committee; and

3) the safeguards in place to promote a balanced review by the committee, which must include review and approval by persons not on the deal team to the actual transaction.

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<sup>3</sup> The NASD stated that the purpose of the “catch-all” provision in paragraph (a)(2) is to avoid attempts to circumvent the Rule by re-characterizing payments as something other than for advisory services. This disclosure requirement was qualified in Amendment No. 4 to the Rule so as to require that only “significant” other payments be disclosed in order to ease the compliance burden on member firms. See NASD Proposal at 9-10 and SEC Approval Release at 6.

<sup>4</sup> Rules 2290(a)(1) and (2) require that only the existence, as opposed to the amount, of compensation must be disclosed. See NASD Proposal at 9-10.

<sup>5</sup> NASD Proposal at 36-37; SEC Approval Release at 10.

The member firm's procedures must also include the process to determine whether the valuation analyses used in the fairness opinion are appropriate, Rule 2290(b).

### **III. Comment**

Most of the disclosures required by Rule 2290(a) are routinely made often both in fairness opinions themselves, as well as in proxy statements issued in connection with the types of transactions in which fairness opinions are utilized. However, the required disclosure concerning the use of a fairness opinion committee approval process and whether or not the opining member is passing on insider compensation arrangements are not presently routine. Members should review their fairness opinion check lists and their templates for fairness opinions to assure that these required disclosures will be included. Members should also review their compliance manuals to assure themselves that their fairness opinion procedures comply with the Rule.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jon Mark at (212) 701-3100 or [jmark@cahill.com](mailto:jmark@cahill.com).