

November 14, 2000

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-99-60**
Restrictions on the Purchase and Sale of Initial Equity Public Offerings
Amendment No. 2

Dear Ms. England:

It has been brought to our attention that in order for the Securities and Exchange Commission to publish the above-referenced rule filing for comment in the Federal Register, it is necessary to submit a "redline" version comparing the rule text in Amendment No. 2 with the rule text as originally proposed in the Federal Register on January 18, 2000. Enclosed is a "redline" version of the proposed rule change. New text is underlined; deleted text is in brackets. Also enclosed is a 3-1/2" disk containing the document in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Gary L. Goldsholle, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8104; e-mail gary.goldsholle@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

Enclosures

cc: Florence Harmon
Heather Traeger

Rule 2790. [Trading in Hot Equity Offerings]

(Note: Section (a) “Definitions” has been renumbered as Section (i). The comparison of changes to the definitions is located under Section (i).)

[(b)] Restrictions on the Purchase and Sale of Initial Equity Public Offerings

(a) General Prohibitions

(1) A member or a person associated with a member may not sell, or cause to [sell,] be sold, a [hot] new issue [in a public offering] to any account in which a restricted person [or a member of the restricted person’s immediate family] has a beneficial interest, except as otherwise permitted herein [or through an exemption pursuant to the Rule 9600 Series].

(2) A member or a person associated with a member may not purchase a [hot issue in a public offering, except as permitted herein or through an exemption pursuant to the Rule 9600 Series.] new issue in any account in which such member or person associated with a member has a beneficial interest, except as otherwise permitted herein.

(3) A member may not continue to hold [hot issues acquired in a public offering except as permitted herein or through an exemption pursuant to the Rule 9600 Series.] new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

[(c) Canceling Trades

A member or a person associated with a member does not violate this rule if it cancels a sale of a hot issue made to the account of a restricted person or a member of the person’s immediate family prior to the end of the first business day following the date that market trading

commences (i.e., T+1) and reallocates such hot issue at the public offering price to a non-restricted person.

(d)](b) Preconditions for Sale

Before selling a [hot] new issue to any account, a member must in good faith have obtained within the [previous] twelve months [documentary evidence] prior to such sale, a representation from the account holder(s), or a person authorized to represent the beneficial owners of the account [or the ultimate purchasers if the account is a conduit account, demonstrating that no restricted person or ultimate purchaser in the case of a conduit account, has a beneficial interest in the account, except as permitted under the rule. Members], that the account is eligible to purchase new issues in compliance with this rule. A member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. A member shall maintain a copy of all records and information [used to determine that] relating to whether an account [does not contain a restricted person] is eligible to purchase new issues in its files for at least three years following the member's last sale of a [hot] new issue to that account.

[(e) General Exemptions](c) General Exemptions

[A member or a person associated with a member may sell hot issues to:] The general prohibitions in paragraph (a) of this rule shall not apply to sales to and purchases by:

[(1) A registered investment company](1) An investment company registered under the Investment Company Act of 1940[.];

[(2) A collective investment account (including a joint back office broker/dealer or a collective investment account with a joint back office broker/dealer subsidiary),] (2) A common trust fund or similar fund as described in Section 3(a)(12)(A)(iii) of the Act, provided that:

(A) the fund has investments from 1,000 or more trust accounts; and

(B) the fund does not limit beneficial interests in the fund principally to trust accounts of restricted persons;

(3) An insurance company general, separate or investment account, provided that:

(A) the account has investments from 1,000 or more policyholders; and

(B) the insurance company does not limit beneficial interests in the account principally to restricted persons;

(4) An account that is beneficially owned in part by restricted persons, provided that such restricted persons in the aggregate own less than 5% of such account, and that:.]

[(3) A publicly traded corporation (other than an affiliate of a broker/dealer) listed on an exchange or The Nasdaq Stock Market, in which no person with a 10% or more ownership interest is a restricted person.] (A) each such restricted person does not manage or otherwise direct investments in the account; and

[(4) A foreign] (B) on a pro rata basis, each such restricted person who is a natural person receives less than 100 shares of any new issue;

(5) A publicly traded entity (other than a broker/dealer) that is listed on a national securities exchange or is traded on the Nasdaq National Market, provided that the gains or losses from new issues are passed on directly or indirectly to public shareholders;

(6) An investment company organized under the laws of a foreign jurisdiction, [meeting the following criteria:] provided that:

[(A) the company has 100 or more investors;

(B) the ~~](A)~~ the investment company is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority; and

~~(B)](C)]~~ no person owning more than 5% of the shares of the investment [company's assets shall be invested in a particular hot issue; and,

(D) no person owning more than a 5% interest in such] company is a restricted person[.];

~~[(5) An employee benefits plan qualified under the]~~ (7) An Employee Retirement Income Security Act [provided that the plan sponsor is not a member or an affiliate; or a state or foreign government employee benefit] benefits plan that is qualified under Section 401(a) of the Internal Revenue Code, provided that such plan is not sponsored solely by a broker/dealer;

(8) A state or municipal government benefits plan that is subject to [separate] state [and] and/or municipal regulation; or].

~~[(6)](9)~~ A tax exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code.

~~[(7) Employees and directors of the issuer, an entity which controls, is controlled by, or is under common control of the issuer.]~~

(d) Issuer-Directed Securities

~~[(8) An immediate family member of a restricted person in paragraph (a)(11)(B) if:]~~ The prohibitions on the purchase and sale of new issues in this rule shall not apply to securities that:

~~[(A) such restricted person does not directly or indirectly provide material support to, or receive material support from, the immediate family member;]~~

(1) are specifically directed by the issuer; provided, however, that this exemption shall not apply to securities directed by the issuer to an account in which any restricted person specified in subparagraphs (i)(10)(B) or (i)(10)(C) of this rule has a beneficial interest, unless such person, or a member of his or her immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer. Also, for purposes of this subparagraph (d)(1) only, a parent/subsidiary relationship is established if the parent has the right to vote 50% or more of a class of voting security of the subsidiary, or has the power to sell or direct 50% or more of a class of voting securities of the subsidiary;

[(B) such restricted person is not employed by the member,]

(2) are part of a program sponsored by the issuer or an affiliate of the issuer that [member, selling the hot issue to the immediate family member; and

(C) such restricted person has no ability to control the allocation of the hot issue.

(9) An immediate family member of a restricted person in paragraphs (a)(11)(C)-(D) if such restricted person does not directly or indirectly provide material support to the member of the immediate family;

(10) A restricted person in paragraph (a)(11)(E) provided that the sale is to an account established for the benefit of bona fide public customers, including insurance company general, separate and investment accounts, and bank trust accounts.

(f) Anti-Dilution Provisions

The restrictions on the sale of hot issues in this rule shall not apply to sales to a restricted person in an initial public offering who] meets the following criteria:

(a) the opportunity to purchase a new issue under the program is offered to at least 10,000 participants;

(b) every participant is offered an opportunity to purchase an equivalent number of shares, or will receive a specified number of shares under a predetermined formula applied uniformly across all participants;

(c) if not all participants receive shares under the program, the selection of the participants eligible to purchase shares is based upon a random or other non-discretionary allocation method;

(d) the class of participants does not contain a disproportionate number of restricted persons as compared to the investing public generally; and

(e) sales are not made to participants who are managing underwriter(s), the broker/dealer administering the program (“Administering Broker/Dealer”), the officers or directors of the managing underwriter(s) or Administering Broker/Dealer, or any employee of the managing underwriter(s) or Administering Broker/Dealer with access to non-publicly available information about the new issue; or

(3) are directed to eligible purchasers as part of a conversion offering in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering.

(e) Anti-Dilution Provisions

The prohibitions on the purchase and sale of new issues in this rule shall not apply to an account in which a restricted person has a beneficial interest that meets the following conditions:

(1) the restricted person has held an equity ownership interest in the issuer, or a company that has been acquired by the issuer in the past year, for a period of one year prior to the effective date of the [public] offering;

(2) the sale of the [hot issues] new issue to the [restricted person] account shall not increase the restricted person's percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement [with the SEC] in connection with the offering;

(3) the sale of [hot issues to the restricted person must not include any special terms;
and

(4) the hot issues purchased pursuant to this subsection shall be restricted from sale or transfer for a period of three months following the effective date of the offering.

(g) Conversion Offerings

The rule shall not apply to the sale of securities directed by the issuer of a conversion offering, either on an underwritten or non-underwritten basis, to any person eligible to purchase securities in accordance with the governmental agency or instrumentality having authority to

regulate such conversion offering.] the new issue to the account shall not include any special terms; and

(4) the new issue purchased pursuant to this subparagraph (e) shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

(f) Stand-by Purchasers

The prohibitions on the purchase and sale of new issues in this rule shall not apply to the purchase and sale of securities pursuant to a stand-by agreement that meets the following conditions:

(1) the stand-by agreement is disclosed in the prospectus;

(2) the stand-by agreement is the subject of a formal written agreement;

(3) the managing underwriter(s) represents in writing that it was unable to find any other purchasers for the securities; and

(4) the securities sold pursuant to the stand-by agreement shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

(g) Under-Subscribed Offerings

Nothing in this rule shall prohibit an underwriter, pursuant to an underwriting agreement, from placing a portion of a public offering in its investment account when it is unable to sell that portion to the public.

(h) Exemptive Relief

Pursuant to the Rule 9600 series, the staff, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally exempt any person, security or transaction (or any class or classes of persons, securities or transactions) from this rule to the extent that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.

(i) Definitions

(1) [“Affiliate” shall have the same meaning as in Rule 2720 (b)(1).

(2)]“Beneficial interest” means any [ownership or other direct financial interest] economic interest, such as the right to share in gains or losses. The receipt of a management or performance based fee for operating a collective investment account shall not be considered a beneficial interest in the account.

[(3)](2) “Collective investment account” means any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle [that manages assets of other persons. Collective investment account shall not include any entity in which the decision to buy or sell securities is made jointly by each of the persons investing in the entity or by a member of their immediate family.].

[(4)](3) “Conversion offering” means any offering of securities made as part of a plan by which a savings and loan association, insurance company, or other organization converts from a mutual to a stock form of ownership.

[(5) “Hot issue” means any security that is part of a public offering if the volume weighted price during the first five minutes of trading in the secondary market is 5% or more above the public offering price.]

(4) “Family partnership” means a partnership comprised solely of immediate family members.

[(6)](5) “Immediate family member” [shall include] means a person’s parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person[, directly or indirectly,] provides material support.

[(7) “Joint back office broker/dealer” means any domestic or foreign private investment fund that has voluntarily registered as a broker/dealer solely to take advantage of more favorable margin treatment afforded under Section 220.7 of Regulation T of the Federal Reserve. The activities of a joint back office broker/dealer must not require that it register as a broker/dealer under Section 15(a) of the Act.]

(6) “Investment club” means a group of friends, neighbors, business associates, or others that pool their money to invest in stock or other securities and are collectively responsible for making investment decisions.

[(8)](7) “Limited business broker/dealer” means any broker/dealer whose authorization to engage in the securities business is limited solely to the purchase [or] and sale of [either] investment company/variable contracts securities [or] and direct participation program securities.

[(9)] (8) “Material support” means directly or indirectly providing more than [10%] 25% of a person’s income [or expenses. Material support shall be presumed for members] in the current or prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with material support.

(9) “New issue” means any initial [.

(10) “Public offering” means any initial or secondary] public offering of an equity security as defined in [section] Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular, [including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition,] or other securities distributions of any kind whatsoever, including securities that are specifically directed by the issuer on a non-underwritten basis. [Public offering] New issue shall not include:

(A) [Offerings] offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act of [1933 or SEC Rule 504, 505 or]1933, or SEC Rule 504 if the securities are “restricted securities” under SEC Rule 144(a)(3), or Rule 505 or Rule 506 adopted thereunder; [and]

(B) [Offerings] offerings of exempted securities as defined in Section 3(a)(12) of the Act;

(C) rights offerings, exchange offers, or offerings made pursuant to a merger or acquisition;

(D) offerings of investment grade asset-backed securities;

(E) offerings of convertible securities;

(F) offerings of preferred securities; and

(G) offerings of securities of closed-end companies as defined under Section (5)(a)(2) of the Investment Company Act of 1940.

(10)[(11)] “Restricted person” [includes] means:

(A) Members or other broker/dealers[, unless the ultimate purchaser is a non-restricted person purchasing the security at the public offering price;];

[(B) Officers, directors, general partners, employees or agents](B)

Broker/Dealer Personnel

(i) Any officer, director, general partner, associated person, or employee of a member or any other broker/dealer (other than a limited business broker/dealer), or any agent of a member or any other broker/dealer (other than a limited business broker/dealer) that is engaged in the investment banking or securities business;[;]

[(C)](ii) An immediate family member of a person specified in subparagraph (B)(i) if the person specified in subparagraph (B)(i):

(a) materially supports, or receives material support from, the immediate family member;

(b) is employed by or associated with the member, or an affiliate of the member, selling the new issue to the immediate family member; or

(c) has an ability to control the allocation of the new issue.

(C) Finders and Fiduciaries

(i) With respect to the security being offered, [finders] a finder or any person acting in a fiduciary capacity to the managing underwriter, including, but not limited to, attorneys, accountants and financial consultants; and

(ii) An immediate family member of a person specified in subparagraph (C)(i) if the person specified in subparagraph (C)(i) materially supports, or receives material support from, the immediate family member.

(D) Portfolio Managers

(i) Any person who has authority to buy or sell[(D) Any employee or other person who supervises, or whose activities directly or indirectly involve or are related to, the buying or selling of] securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account, other than with respect to a beneficial interest in the bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account over which such person has investment authority; [;

[(E) Any affiliate of a broker/dealer (other than a limited business broker/dealer); and](ii) An immediate family member of a person specified in subparagraph (D)(i) that is materially supported by such person, other than with respect to a beneficial interest in the bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account over which such person has investment authority.

[(F) Any natural person or member of the person's immediate family who owns 10% or more or has contributed 10% or more of the capital of a broker/dealer (other than a limited business broker/dealer).] Provided, however, that the term "restricted person" under this subparagraph (D) shall not include a person solely because he or she is a participant in an investment club or a family partnership.

(E) Persons Owning a Broker/Dealer

(i) Any person listed, or required to be listed, in Schedule A of a Form BD, except persons with ownership interests of less than 10%;

(ii) any person listed, or required to be listed, in Schedule B of a Form BD, except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A with an ownership interest of less than 10%;

(iii) any person listed, or required to be listed, in Schedule C of a Form BD that meets the criteria of subparagraphs (E)(i) and (E)(ii) above;

(iv) any person that directly or indirectly owns 10% or more of a public reporting company listed on Schedule A of a Form BD (other than a reporting company that is listed on a national securities exchange or is traded on the Nasdaq National Market, provided that the gains or losses from new issues are passed on directly or indirectly to public shareholders);

(v) Any person that directly or indirectly owns 25% or more of a public reporting company listed on Schedule B of a Form BD (other than a reporting

company that is listed on a national securities exchange or is traded on the Nasdaq National Market, provided that the gains or losses from new issues are passed on directly or indirectly to public shareholders).

(vi) An immediate family member of a person specified in subparagraphs (E)(i)-(v) unless the person owning the broker/dealer:

(a) does not materially support, or receive material support from, the immediate family member;

(b) is not an owner of the member, or an affiliate of the member, selling the new issue to the immediate family member; and

(c) has no ability to control the allocation of the new issue.