

March 19, 2001

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

Re: **File No. SR-NASD-99-60**
Restrictions on the Purchase and Sale of Initial Equity Public Offerings
Amendment No. 3

Dear Ms. England:

On October 10, 2000, NASD Regulation filed with the Securities and Exchange Commission (“SEC”) Amendment No. 2 to proposed Rule 2790, Restrictions on the Purchase and Sale of Initial Equity Public Offerings. The SEC published the amended proposed rule change for comment on November 28, 2000¹ and received 12 comment letters.² As a threshold matter, none of the comment letters present any issues under Section 15A(b) of the Securities Exchange Act of 1934 (“Exchange Act”) that should affect the Commission’s swift approval of the proposed rule change. In general, the comment letters offer a number of suggestions to improve the clarity and consistency of the proposed rule change. Some comment letters also seek additional exemptions that are not in the current Interpretation and that NASD Regulation has decided not to pursue at this time. NASD Regulation’s decision not to

¹ SEC Release No. 34-43627, 65 Fed. Reg. 76316 (Dec. 6, 2000).

² Letter from The Washington Group to Jonathan G. Katz, SEC, dated December 21, 2000 (“Washington”); Letter from Fried, Frank, Harris, Shriver & Jacobson to Jonathan G. Katz, SEC, dated December 22, 2000 (“Fried”); Letter from Capital International, Inc. to Jonathan G. Katz, SEC, dated December 22, 2000 (“CII”); Letters from Cadwalader, Wickersham & Taft to Jonathan G. Katz, SEC, dated December 22, 2000 and January 4, 2001 (“Cadwalader”); Letter from Testa, Hurwitz & Thibeault to Jonathan G. Katz, SEC, dated December 26, 2000 (“Testa”); Letter from Managed Funds Association to Jonathan G. Katz, SEC, dated December 26, 2000 (“MFA”); Letter from Mayor, Day, Caldwell & Keeton, L.L.P. to Jonathan G. Katz, SEC, dated December 26, 2000 (“Mayor”); Letter from Sullivan & Cromwell to Jonathan G. Katz, SEC, dated December 29, 2000 (“Sullivan”); Letter from Willkie Farr & Gallagher to Jonathan G. Katz, SEC, dated January 8, 2001 (“Willkie”); Letter from Securities Industry Association to Margaret H. McFarland, SEC, dated January 10, 2001 (“SIA”); Letter from Chicago Board Options Exchange to Jonathan G. Katz, SEC, dated January 12, 2001 (“CBOE”).

incorporate these additional exemptions in the proposed rule change should in no way delay Commission action on the proposed rule change, which we believe provides substantial benefit to investors and members.

NASD Regulation has reviewed the comment letters and recommends the following changes to proposed Rule 2790.³ For ease of review, the discussion of the comments is organized to correspond to the provisions in the proposed rule change. The revised text of proposed Rule 2790 is attached as Exhibit 1. A redline version of the text of proposed Rule 2790 showing the changes in Amendment No. 3 as compared with Amendment No. 2 is attached as Exhibit 2.

(a) General Prohibitions

The SIA expressed concern that the general prohibitions of the proposed rule change are too restrictive and may cause unintended compliance problems in several instances. The SIA noted that the proposed rule change could be read to prohibit an underwriter from purchasing, for resale to the public at the public offering price, securities from the issuer as part of the distribution, a result it believed was unintended. NASD Regulation agrees that the proposed rule change was never intended to prevent an underwriter or selling group member from purchasing securities from an issuer for distribution to the public at the public offering price. Rather, the proposed rule change prohibits the underwriter or selling group member from continuing to hold such securities.

The SIA also noted that the proposed rule change could be read to prohibit purchases by and among members of the selling group (i.e., intra-syndicate sales) while engaged in the distribution of a new issue. Finally, the SIA noted that the proposed rule change could be read to prohibit accommodation sales (the sale of a new issue to another broker/dealer at the public offering price to enable the purchasing broker/dealer's customer to purchase the new issue at the public offering price). The staff agrees that none of these outcomes were intended by the proposed rule change, and the staff has developed new paragraph (a)(4) to address the SIA's concerns.

(b) Preconditions for Sale

Sullivan expressed concern that the provisions setting forth the preconditions for sale do not adequately address sales to intermediaries such as domestic banks, foreign banks, broker/dealers, investment advisers, and other conduits that purchase new issues on behalf of

³ A copy of the revised text of Rule 2790 is attached as Exhibit 1. A redlined copy of Rule 2790 highlighting the changes from Amendment No. 2 is attached as Exhibit 2.

their customers. Sullivan noted that these intermediaries are permitted to purchase hot issues under the current Interpretation so long as the beneficial owners of the securities are not restricted persons. Sullivan believed that the representations required in the proposed rule change would be very difficult to satisfy for sales to intermediaries, which may not have identified the beneficial owners of the securities at the time of purchase or may not be authorized to represent the beneficial owners of the purchasing accounts. To address Sullivan's concerns, we have expanded the section on preconditions for sale to permit a representation from a bank, foreign bank, broker/dealer, investment adviser, or other conduit, stating that all purchases of new issues are in compliance with Rule 2790.

In addition, Fried believed that the proposed rule change should expressly state that a member may rely upon representations made by a person who the member "reasonably believes" is authorized to represent the beneficial owners of the account. NASD Regulation believes that members should use an appropriate level of due diligence to determine whether an individual is authorized to represent the beneficial owners of the accounts and that it is unnecessary to include the language Fried suggests.

(c) General Exemptions

Sullivan expressed concern that the general exemptions apply only to the persons specified in the rule and do not extend to the accounts of such persons. The staff agrees that the first sentence setting forth the general exemptions should clearly state that the exemptions apply to the specified persons and to the accounts of such persons. NASD Regulation staff has modified the text of the proposed rule change as recommended by Sullivan.

- (1) Registered Investment Companies Exemption**
- (2) Common Trust Funds Exemption**
- (3) Insurance Company Accounts Exemption**

No changes.

(4) *De minimis* Exemption

Paragraph (c)(4) sets forth a so-called *de minimis* exemption, which allows an account that is beneficially owned in part by restricted persons to purchase new issues provided that such restricted persons in aggregate own less than 5% of the account, that such restricted persons' interests are passive, and that no individual restricted person receives more than 100

shares of any new issue.⁴ Several commenters believed that the 100 share limit was too low. The staff disagrees. The inclusion of a *de minimis* exemption in the proposed rule change represents a substantial change from the current Interpretation, which has no such exemption. NASD Regulation believes that in adopting a *de minimis* exemption it is appropriate to set a level that it believes is in fact *de minimis*. Further, as noted in Amendment No. 2, the *de minimis* exemption would allow purchases of a new issue by any restricted person, including broker/dealer personnel. To ensure that the exemption is not inconsistent with the purposes of the rule, NASD Regulation believes that it is necessary to set a limit that will eliminate the incentives for self-dealing and the appearance that restricted persons are receiving shares of initial equity public offerings at the expense of public investors. For these reasons, NASD Regulation intends to retain the 100 share maximum.

Several commenters have urged NASD Regulation to expand the *de minimis* exemption into a passive investor exemption. This request is not new. NASD Regulation has for many years received requests to adopt a passive investor exemption. NASD Regulation continues to believe that a passive investor exemption is inconsistent with the purposes of the proposed rule change. The purpose of the proposed rule change is, among other things, to ensure that members distribute securities in an initial public offering to public investors. In the context of this rule, public investors are those without a nexus to the brokerage or financial industry as defined in the rule. A passive investor exemption of the type urged by the commenters would allow persons who are not public investors to receive substantial allocations of initial public offerings, which is fundamentally at odds with the purposes of the rule. The Commission has not deemed a passive investor exemption to be necessary in the current Interpretation, and we do not believe that one is necessary in the proposed rule change.

NASD Regulation staff has made a technical amendment to the limitations on a restricted person's ability to control investment decisions in the account to correspond to similar standards used for control by portfolio managers in paragraph (i)(10)(D). NASD Regulation also will clarify in a *Notice to Members* announcing adoption of the rule that in complying with the 100-share limit, members may look through an investing entity to a natural person's beneficial interest.

(5) Publicly Traded Entity Exemption

The proposed rule change establishes an exemption for sales to and purchases by a publicly traded entity (other than a broker/dealer) that is listed on a national securities exchange

⁴ In response to several commenters, NASD Regulation staff is clarifying that the exemption allows a restricted person to purchase up to 100 shares, not less than 100 shares.

or is traded on the Nasdaq National Market. Commenters generally supported this exemption but were concerned about the additional requirement that the gains and losses from new issues of a publicly traded entity be passed on to its public shareholders. Commenters noted that tracing the proceeds from new issues within a publicly traded company would be nearly impossible, and in some cases requiring allocation to shareholders may be inconsistent with rights of debt holders. NASD Regulation agrees that this standard is difficult to apply and believes that it is unnecessary in view of the disclosure and other legal constraints on public companies. Accordingly, the staff has eliminated this requirement.

In addition, in response to a comment from Fried, the staff has expanded the exemption to permit purchases by a publicly traded foreign entity (other than a broker/dealer) that meets the quantitative designation criteria for listing on a national securities exchange or the Nasdaq National Market.

(6) Foreign Investment Companies Exemption

No changes.

(7) ERISA Benefits Plan Exemption

(8) State and Municipal Government Benefits Plan Exemption

The proposed rule change exempts sales to and purchases by an ERISA benefits plan that is qualified under Section 401(a) of the Internal Revenue Code (“Code”), provided that such plan is not sponsored by a broker/dealer. The proposed rule change also exempts state and municipal government benefits plans. CII recommended extending these exemptions to foreign governmental and foreign non-governmental employee benefits plans. With respect to foreign employee benefits plans generally, NASD Regulation does not believe that an outright exemption is appropriate because of the wide range of regulation governing employee benefits plans in various jurisdictions. NASD Regulation will in the future consider whether standards could be developed to address foreign employee benefits plans.

CII also stated that the proposed rule change should exempt sales to and purchases by church plans as described in Section 414(e) of the Code. CII stated that church plans are operated for the benefit of employees of a church or a convention or association of churches, which is exempt from tax under Section 501 of the Code. CII stated that although church plans are not qualified under Section 401(a) of the Code (as are ERISA plans), they operate in a similar manner. NASD Regulation staff believes that the rationale for exempting ERISA plans qualified under Section 401(a) of the Code applies equally to church plans as defined under

Section 414(e) of the Code. NASD Regulation staff has amended the proposed rule change accordingly.

(9) Tax Exempt Charitable Organizations Exemption

No changes.

(d) Issuer-Directed Securities

The proposed rule change provides issuers with greater flexibility to control the allocation of their securities. Fried generally supported these changes, but noted that the proposed rule change does not expressly permit an issuer to allocate its securities to employees and directors of *sister companies* of the issuer as described in the commentary to the proposed rule change. This was an inadvertent omission by NASD Regulation staff and has been corrected.

Paragraph (d)(2) provides an exemption for issuer-directed securities that are part of a program offered broadly to 10,000 or more participants, subject to certain conditions. Fried stated that the condition in paragraph (d)(2)(e), which requires that a member ensure that sales are not made to persons who are officers and directors of the managing underwriter(s) or the broker/dealer administering the program, would undermine the effectiveness of the exemption. Specifically, Fried stated that if a member were required to investigate the facts about each of the 10,000 purchasers in such a program, it would largely vitiate the relief. NASD Regulation staff agrees. In view of the other limitations on the operation of such programs, the staff does not believe it is necessary to retain the condition in paragraph (d)(2)(e).

Testa sought additional guidance on the meaning of the requirement that “the class of participants does not contain a disproportionate number of restricted persons as compared to the investing public.” NASD Regulation has included this condition to ensure that a program is not directed to a group of persons that is comprised to a significant extent of restricted persons. If an issuer has any questions about whether a specific program would satisfy this condition, the issuer should contact NASD Regulation’s Office of General Counsel for an interpretation.

(e) Anti-Dilution Provisions

Testa noted several drafting errors with respect to the anti-dilution provisions and NASD Regulation staff has made the necessary corrections.

(f) Stand-by Purchasers

No changes.

(g) Under-Subscribed Offerings

Sullivan supported the provisions in the proposed rule change that permit an underwriter to place a portion of an offering in its investment account when it is unable to sell that portion to the public. However, Sullivan believed that this provision should be extended to permit an underwriter, in lieu of placing the securities in its own investment account, to be able to sell such securities to one or more restricted persons. NASD Regulation staff disagrees with this recommendation. The provisions pertaining to under-subscribed offerings were added to ensure that the proposed rule change is not inconsistent with an underwriter's contractual obligations to the issuer. NASD Regulation does not believe that these provisions should be used to allow an underwriter to sell new issues to restricted persons.

(h) Exemptive Relief

No changes.

(i) Definitions

(1) Beneficial Interest

In Amendment No. 2, NASD Regulation revised the definition of "beneficial interest" in an effort to clarify that the focus of the proposed rule change is on persons with an economic, rather than a legal, interest in new issues. In the Notice describing the proposed rule change, NASD Regulation stated that "legal ownership, such as that held by a trustee for beneficiaries, or a hedge fund for its limited partners, is not the type of [beneficial] interest that is the focus of the rule."⁵ NASD Regulation staff has amended the proposed rule change to expressly exclude from the definition of beneficial interest "fees for acting in a fiduciary capacity." This amendment further clarifies that a person who acts, for example as a trustee, executor or custodian, and receives a fee for providing such services, is not deemed to have a beneficial interest in the account.

⁵ 65 Fed. Reg. at 76325.

(2) Collective Investment Account

Fried noted that the definition of collective investment account might sweep in operating companies whose investment in securities is only a small and ancillary part of their operations. NASD Regulation agrees that the definition of collective investment account was not intended to include such companies and has amended the definition accordingly.

(3) Conversion Offering

No changes.

(4) Family Partnership

Cadwalader stated that the definition of family partnership is too restrictive and fails to recognize the other types of investment vehicles that a family might establish for its investments. To address Cadwalader's concerns, the staff has defined "family investment vehicle" to mean any company that is beneficially owned solely by immediate family members. NASD Regulation will apply the same definition of "company" as is used under the Exchange Act.

Cadwalader also asked NASD Regulation to expand the definition of family investment vehicle to include participation by "long-term family employees." NASD Regulation staff believes that any concerns about the application of the proposed rule change in these limited situations is best addressed through the exemptive process on a case-by-case basis.

(5) Immediate Family Member

(6) Investment Club

No changes.

(7) Limited Business Broker/Dealer

The proposed rule change, like the current Interpretation, deems a broker/dealer whose securities business is limited solely to the purchase and sale of investment company/variable contract securities and direct participation securities to be a limited business broker/dealer and, in general, excludes persons associated with such firms from the restrictions of the rule. Fried believed that members should be able to rely solely upon a firm's response on Form BD to determine whether a firm is a limited business broker/dealer. In completing Form BD, a broker/dealer is required only to list all lines of business that account for 1% or more of the firm's annual revenue. Thus, while a firm's Form BD may be evidence of the types of business

in which a firm engages, NASD Regulation staff does not believe that reviewing a firm's Form BD alone will satisfy a member's obligation to determine whether a firm is a limited business broker/dealer.⁶ NASD Regulation believes that the limited business category should be construed narrowly and should only apply to firms that are authorized solely to engage in the purchase and sale of investment company/variable contract securities and direct participation securities. In defining a limited business broker/dealer by reference to what business "it is authorized to engage in," NASD Regulation has made a decision not to extend the limited business designation to a firm based upon the level of revenues in a particular line of business, which may vary from year to year.

The CBOE continued to state that its floor brokers and market makers should be exempt from the proposed rule change.⁷ NASD Regulation believes that the rule should in general apply to all broker/dealers and their associated persons. A rule that looks to activities of a particular broker/dealer or its associated persons would, in the staff's view, be more difficult rule to administer and enforce. The staff recognizes that the current Interpretation and the proposed rule change make a distinction with respect to associated persons of firms that engage solely in the purchase and sale of investment company/variable contract securities and direct participation securities; however, the staff does not believe this requires additional exemptions from the rule. NASD Regulation staff believes that the CBOE's request should be considered only in the context of a much broader reconsideration of whether the rule should apply to all broker/dealers in general, and NASD Regulation staff does not intend to undertake that review as part of the proposed rule change. While NASD Regulation in the future may consider a different approach, it declines to do so now. The scope of broker/dealers and associated persons that are restricted persons in the proposed rule change is essentially the same as the current Interpretation and need not change in connection with the proposed rule change.⁸

⁶ In the initial rule filing, NASD Regulation stated that a member "should look to the Form BD as well as any Restrictive Agreement." SEC Release No. 34-42325, 65 Fed Reg. 2656, 2662 (Jan. 18, 2000). Upon further review, the staff wishes to clarify that a member may look to a Form BD as evidence of a firm's status, but the proposed rule change would require the member to inquire further about whether the firm meets the conditions of a limited business broker/dealer.

⁷ See In re Equity Securities Trading Co., Inc., Exchange Act Rel. No. 39520 (Jan. 7, 1998).

⁸ The SEC staff has asked whether the proposed rule change would apply to persons associated with a futures commission merchant that elects to register with the SEC as a broker/dealer under the notice registration provisions of the Commodity Futures Modernization Act of 2000. NASD Regulation staff preliminarily believes that from a policy perspective there is no basis to distinguish between firms that engage in a business in security futures as opposed to the underlying securities. Accordingly, NASD Regulation believes that all firms required to register (including notice register) as a broker/dealer should be treated equally.

(8) Material Support

Material support is defined as providing more than 25% of a person's income in the current or prior calendar year. Fried believed that looking to the current or past calendar years was arbitrary and that it would be more accurate if the definition of material support was based upon a relationship in the previous twelve months. The staff has not adopted the definition recommended by Fried. In response to the initial proposal, Schwab stated that the "rule should provide a specific time period for measuring the provision of support" and specifically proposed looking to the "prior calendar year." NASD Regulation believes that Schwab's proposal is generally easier to administer and has adopted its proposal. To provide even more certainty to the definition of material support, the staff has eliminated the references to the "current calendar year" and will base material support entirely upon providing income to a person in the prior calendar year.

Fried also requested that the presumption that immediate family members living in the same household provide each other with material support be limited solely to spouses. NASD Regulation believes that the relationship between any members of the immediate family who choose to live together in the same household are sufficiently intertwined that they should be treated as providing each other with material support.

(9) New Issue

Several commenters noted that the reference in the new issue definition for "other securities distributions of any kind whatsoever, including securities that are specifically directed by the issuer on a non-underwritten basis" was surplusage and potentially misleading given the exclusions from the definition provided in the rule. NASD Regulation staff agrees and has deleted this language from the definition.

Sullivan suggested that for purposes of clarity, the exclusion in paragraph (i)(9)(A) should expressly reference Rule 144A (which is an exemption under Section 4(1) of the Securities Act of 1933). We agree and have included a reference to Rule 144A in the proposed rule change.

The MFA and Cadwalader stated that offerings of securities of commodity pools should not be covered by the proposed rule change. While many offerings of commodity pools are effected through private placements, and thus exempt from the rule, an increasing number of commodity pools are being offered publicly. The commenters noted that commodity pools, whether offered publicly or privately, generally do not trade in the secondary market. The

MFA added that no commodity pools are currently listed and traded on a U.S. stock exchange. Rather, the commenters noted that investors may redeem their interests from the issuer at net asset value at selected intervals, much like open-end mutual funds. In addition, they stated that the offering process is similar to registered closed-end funds in that the commodity pool operator is generally seeking as large an infusion of capital as possible (in this case to invest in commodity futures) and that such offerings are rarely oversubscribed. NASD Regulation staff has amended the proposed rule change to exclude offerings of commodity pools from the definition of new issue.

Cadwalader agreed with NASD Regulation's rationale and decision to exempt offerings of closed-end investment companies from the definition of new issue but questioned why the exemption did not extend to open-end investment companies. Because the current Interpretation applies to offerings that trade in a premium in the secondary market (a "hot issue"), and open-end funds do not trade in the secondary market, the staff did not focus on the application of the rule to the offering of open-end investment companies. However, with the proposed rule change applying to all initial offerings of equity securities, we agree with Cadwalader that offerings of all registered investment companies should be exempt from the rule and have made the necessary amendments.

Several commenters suggested that the list of offerings excluded from the definition of new issue should include warrants and exchange securities. NASD Regulation does not believe that these commenters have demonstrated the rationale for exempting offerings of such securities from the rule. However, NASD Regulation retains exemptive authority under the proposed rule change and can consider in the future whether the exclusion of additional securities from the definition of new issue is consistent with the purposes of the rule.

Fried stated that the proposed rule change should be clarified to provide that a new issue does not include the initial offering of equity in the United States by an issuer whose equity is publicly traded in another country. While NASD Regulation may agree with Fried that in many instances such an offering in the United States should be exempt from the proposed rule change, the staff prefers to address such offerings on a case-by-case basis under its exemptive authority. As the staff gains greater familiarity with the circumstances surrounding such offerings, it may propose to the Board a more general exemption.

(10) Restricted Person

- (A) Members of Other Broker/Dealers**
- (B) Broker/Dealer Personnel**
- (C) Finders and Fiduciaries**

No changes.

(D) Portfolio Managers

In Amendment No. 2, NASD Regulation made several significant revisions to the category of portfolio managers that are treated as restricted persons. NASD Regulation stated that only those portfolio managers that have authority to make investment decisions are restricted persons. NASD Regulation also stated that a portfolio manager is not a restricted person with respect to the account over which he or she has investment authority. Commenters, including Cadwalader, supported these changes. Several commenters offered alternative formulations of the definition, which they believe were easier to understand. NASD Regulation has reviewed these comments and amended the definition of restricted person for portfolio managers to provide greater clarity.

Fried suggested that the scope of portfolio managers who are restricted persons in the proposed rule change should be defined with reference to whether a person “exercises” authority to make investment decisions, rather than whether such person is “authorized” to make investment decisions. NASD Regulation believes that this alternative standard is both too narrow and more subjective, and has not made this change.

Washington recommended excluding from the definition of restricted persons hedge fund managers with less than \$200 million in assets. NASD Regulation believes that the reasons for treating hedge fund managers as restricted persons are not limited by the size of the assets under management, especially with amounts as significant as those proposed by the commenter.

Fried sought clarification that an individual who establishes his or her own account as a corporation would not be deemed a restricted person. NASD Regulation staff believes that the exclusion in paragraph (i)(10)(D) which states that the term “restricted person” under this subparagraph shall not include a person solely because he or she has investment authority in an investment club or a family investment vehicle would address this concern because an individual’s corporation would fall within the definition of a family investment vehicle.

(E) Persons Owning a Broker/Dealer

The proposed rule change defines a restricted person to include certain owners of a broker/dealer. In Amendment No. 2, NASD Regulation stated that rather than develop a new standard, it would use the standards set forth in Schedules A and B of Form BD, with minor modifications.

Willkie noted that the definition of restricted person for persons owning a broker/dealer failed to exclude owners of a limited business broker/dealer. This was an omission in drafting and has been corrected.

Fried stated that NASD Regulation's use of the term "ownership interest" in referring to persons meeting the thresholds for reporting on Schedules A and B was misleading since inclusion on Schedules A and B is not based strictly on ownership, but also includes an element of control. NASD Regulation staff has amended the references to ownership interest to more accurately incorporate the standards in Schedules A and B.

Fried also stated that persons on Schedule B who own less than 10% of a broker/dealer should not be included within the definition of restricted persons. Fried stated that in some cases the new standard of ownership may be more restrictive than the current Interpretation. NASD Regulation recognizes this, but believes that the benefits of relying on Schedule B (and Schedule A) are substantial. As noted in Amendment No. 2, the use of the standards in Schedules A and B of Form BD are advantageous from a compliance perspective because the definitions are understood by members and the information is already required to be maintained. NASD Regulation does not believe it is necessary to narrow the definitions of this category of restricted persons in the manner that Fried suggested.

Fried also suggested excluding from the scope of restricted persons owners of persons listed in Schedules A or B of Form BD that are listed on foreign exchanges. Again, NASD Regulation believes the standards in Schedules A and B as written establish an appropriate basis to deem a person a restricted person. As Schedules A and B exclude only those public companies that are subject to Sections 12 or 15(d) of the Exchange Act, NASD Regulation declines to exclude foreign owners that do not meet these standards.

Other Comments

Sullivan stated that the definition of new issue should expressly exempt offerings of securities under Regulation S. We do not believe that this is merely a matter of clarification as Sullivan suggests. The current Interpretation does not exclude offerings of securities under Regulation S, and the staff did not intend that the proposed rule change exclude offerings under Regulation S. Because this comment was raised late in the rulemaking process, the staff has not had sufficient opportunity to analyze the issue. Moreover, Sullivan has not provided sufficient rationale that an exemption for offerings of securities under Regulation S would be consistent with the purposes of the proposed rule change. The staff is interested in discussing this issue

with commenters, including Sullivan, in more detail, but is not amending the proposed rule change to reflect the suggestion at this time.

Mayor and Washington stated that NASD Regulation should reintroduce the concept of conditionally restricted persons. In its initial rule filing, NASD Regulation explained the rationale for eliminating the conditionally restricted person status.⁹ It also recognized that in eliminating this category, certain persons may be treated differently under the proposed rule change. With its treatment of portfolio managers, NASD Regulation believes that it has adequately and fairly addressed the concerns faced by persons who were formerly treated as conditionally restricted persons. NASD Regulation continues to believe, based upon the comments received and discussions with members and industry personnel, that there is broad support for the elimination of the conditionally restricted person status. For the foregoing reasons, the staff is not amending the proposed rule change to create a conditionally restricted person category.

Fried and Testa stated that the proposed rule change should contain a provision that states that a member does not violate the rule if it cancels the trade by the end of the first business day following the day that market trading commences. Both the Interpretation and the original proposed rule change contain a cancellation provision. NASD Regulation staff believes that those cancellation provisions were necessary to allow members to cancel trades in the event an offering unexpectedly became a hot issue. However, with the decision to apply the rule to all initial equity public offerings, NASD Regulation no longer believes that cancellation provisions are necessary. NASD Regulation believes that members should determine the status of purchasers prior to making the sale of a new issue.

Fried believes that the proposed rule change should exempt mutual banks, in much the same way that mutual insurance companies are excluded. The submission by Fried did not explain the nature of the purchases by such banks. Upon approval of the proposed rule change, NASD Regulation staff would be willing to consider an exemptive request setting forth the basis for excluding mutual banks from the rule.

Testa asked for clarification that the proposed rule change does not affect the stabilization activities under SEC Regulation M. The proposed rule change governs activities in connection with the initial distribution of securities in a public offering and does not have any effect on an underwriter's decision to engage in market stabilization activities, which occur once the security has commenced trading in the secondary market.

⁹ 65 Fed Reg. at 2659-2660.

NASD Regulation staff understands the SIA intends to communicate with private vendors to develop a system that maintains information on the status of persons under the proposed rule change. The staff believes that the proposed rule change as written currently provides the flexibility for a member to use such a system, and the staff is willing to work with the SIA and any third party vendor to assist them with any specific compliance concerns that may arise.

Finally, NASD Regulation staff agrees with Sullivan that a phase-in period for the proposed rule change is appropriate and intends to provide for a 90 day phase-in period during which time members may comply with either Rule 2790 or the Interpretation.

We believe that the foregoing fully responds to material issues raised by the commenters. We encourage the Commission to act as expeditiously as possible in approving the proposed rule change to ensure that the benefits it provides to investors and members may take effect as soon as possible. If the staff of the Commission has any questions concerning these changes, please contact the undersigned at (202) 728-8014, or Gary L. Goldsholle, Associate General Counsel, NASD Regulation, Inc. at (202) 728-8104.

Very truly yours,

Patrice M. Gliniecki
Vice President and
Deputy General Counsel

Attachments

Rule 2790. 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 be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted herein.

(2) A member or a person associated with a member may not purchase a 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 new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

(4) Nothing in this paragraph (a) shall prohibit:

(A) sales or purchases from one member of a syndicate to another member of the syndicate that are incidental to the distribution of a new issue to a non-restricted person at the public offering price; or

(B) sales or purchases by a broker/dealer of a new issue at the public offering price as part of an accommodation to a non-restricted person customer of the broker/dealer.

(b) Preconditions for Sale

Before selling a new issue to any account, a member must in good faith have obtained within the twelve months prior to such sale, a representation from:

(1) Beneficial Owners

the account holder(s), or a person authorized to represent the beneficial owners of the account, that the account is eligible to purchase new issues in compliance with this rule; or

(2) Conduits

a bank, foreign bank, broker/dealer, or investment adviser, or other conduit that all purchases of new issues are 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 relating to whether an account is eligible to purchase new issues in its files for at least three years following the member's last sale of a new issue to that account.

(c) General Exemptions

The general prohibitions in paragraph (a) of this rule shall not apply to sales to and purchases by the following persons, whether directly or through accounts in which such persons have a beneficial interest:

(1) An investment company registered under the Investment Company Act of 1940;

(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:

(A) each such restricted person does not have the authority to buy or sell securities for account; and

(B) on a pro rata basis, each such restricted person who is a natural person receives no more than 100 shares of any new issue;

(5) A publicly traded entity (other than a broker/dealer) that:

(A) is listed on a national securities exchange;

(B) is traded on the Nasdaq National Market, or

(C) is a foreign security that meets the quantitative designation criteria for listing on a national securities exchange or trading on the Nasdaq National Market;

(6) An investment company organized under the laws of a foreign jurisdiction, provided that:

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

(B) no person owning more than 5% of the shares of the investment company is a restricted person;

(7) An Employee Retirement Income Security Act 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 state and/or municipal regulation;

(9) A tax exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code; or

(10) A church plan under Section 414(e) of the Internal Revenue Code.

(d) Issuer-Directed Securities

The prohibitions on the purchase and sale of new issues in this rule shall not apply to securities that:

(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 or the issuer's parent. Also, for purposes of this paragraph (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;

(2) are part of a program sponsored by the issuer or an affiliate of the issuer that 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; and

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

(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 account 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 offering;

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

(3) the sale of the new issue to the account shall not include any special terms; and

(4) the new issue purchased pursuant to this paragraph (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) “Beneficial interest” means any 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, or other fees for acting in a fiduciary capacity, shall not be considered a beneficial interest in the account.

(2) “Collective investment account” means any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale securities.

(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.

(4) “Family investment vehicle” means a company that is beneficially owned solely by immediate family members.

(5) “Immediate family member” 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 provides material support.

(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.

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

(8) “Material support” means directly or indirectly providing more than 25% of a person’s income in the 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 public offering of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular. New issue shall not include:

(A) 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 if the securities are “restricted securities” under SEC Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;

(B) offerings of exempted securities as defined in Section 3(a)(12) of the Act, and rules promulgated thereunder;

(C) offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;

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

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

(F) offerings of convertible securities;

(G) offerings of preferred securities; and

(H) offerings of an investment company registered under the Investment Company Act of 1940.

(10) “Restricted person” means:

(A) Members or other broker/dealers;

(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;

(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, 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 securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account. However, no such person shall be deemed a restricted person for purposes of determining whether the account over which such person has investment authority is a restricted person;

(ii) An immediate family member of a person specified in subparagraph (D)(i) that materially supports, or receives material support from, such person. However, the immediate family member shall not be deemed a restricted person for purposes of determining whether the account over which such person in subparagraph (D)(i) has investment authority is a restricted person.

Provided, however, that the term “restricted person” under this subparagraph (D) shall not include a person solely because he or she has investment authority in an investment club or a family investment vehicle.

(E) Persons Owning a Broker/Dealer

(i) Any person listed, or required to be listed, in Schedule A of a Form BD (other than with respect to a limited business broker/dealer), except persons identified by an ownership code of less than 10%;

(ii) Any person listed, or required to be listed, in Schedule B of a Form BD (other than with respect to a limited business broker/dealer), except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A identified by an ownership code 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, or required to be listed, in 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, or other than with respect to a limited business broker/dealer);

(v) Any person that directly or indirectly owns 25% or more of a public reporting company listed, or required to be listed, in 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, or other than with respect to a limited business broker/dealer).

(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.

New text is underlined, deleted text is in brackets.

Rule 2790. 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 be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted herein.

(2) A member or a person associated with a member may not purchase a 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 new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

(4) Nothing in this paragraph (a) shall prohibit:

(A) sales or purchases from one member of a syndicate to another member of the syndicate that are incidental to the distribution of a new issue to a non-restricted person at the public offering price; or

(B) sales or purchases by a broker/dealer of a new issue at the public offering price as part of an accommodation to a non-restricted person customer of the broker/dealer.

(b) Preconditions for Sale

Before selling a new issue to any account, a member must in good faith have obtained within the twelve months prior to such sale, a representation from:

(1) Beneficial Owners

the account holder(s), or a person authorized to represent the beneficial owners of the account, that the account is eligible to purchase new issues in compliance with this rule ; or

(2) Conduits

a bank, foreign bank, broker/dealer, or investment adviser, or other conduit that all purchases of new issues are 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 relating to whether an account is eligible to purchase new issues in its files for at least three years following the member's last sale of a new issue to that account.

(c) General Exemptions

The general prohibitions in paragraph (a) of this rule shall not apply to sales to and purchases by the following persons, whether directly or through accounts in which such persons have a beneficial interest:

- (1) An investment company registered under the Investment Company Act of 1940;
- (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:

(A) each such restricted person does not have the authority to buy or sell securities for [manage or otherwise direct investments in the] account; and

(B) on a pro rata basis, each such restricted person who is a natural person receives no more than [less] 100 shares of any new issue;

(5) A publicly traded entity (other than a broker/dealer) that:

(A) is listed on a national securities exchange; [or]

(B) is traded on the Nasdaq National Market; or

(C) is a foreign security that meets the quantitative designation criteria for listing on a national securities exchange or trading 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, provided that:

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

(B) no person owning more than 5% of the shares of the investment company is a restricted person;

(7) An Employee Retirement Income Security Act 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 state and/or municipal regulation; [or]

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

(10) A church plan under Section 414(e) of the Internal Revenue Code.

(d) Issuer-Directed Securities

The prohibitions on the purchase and sale of new issues in this rule shall not apply to securities that:

(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 or the issuer's parent. Also, for purposes of this [sub]paragraph (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;

(2) are part of a program sponsored by the issuer or an affiliate of the issuer that 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; and

(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] account 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 offering;

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

(3) the sale of the new issue to the account shall not include any special terms; and

(4) the new issue purchased pursuant to this [sub]paragraph (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) “Beneficial interest” means any 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.

(2) “Collective investment account” means any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale securities.

(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.

(4) “Family [partnership” means a partnership comprised solely of] investment vehicle” means a company that is beneficially owned solely by immediate family members.

(5) “Immediate family member” 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 provides material support.

(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.

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

(8) “Material support” means directly or indirectly providing more than 25% of a person’s income 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 public offering of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular[, or other securities distributions of any kind whatsoever, including securities that are specifically directed by the issuer on a non-underwritten basis]. New issue shall not include:

(A) 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 if the securities are “restricted securities” under SEC Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;

(B) offerings of exempted securities as defined in Section 3(a)(12) of the Act, and rules promulgated thereunder;

(C) offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;

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

~~[(D)]~~(E) offerings of investment grade asset-backed securities;

~~[(E)]~~(F) offerings of convertible securities;

~~[(F)]~~(G) offerings of preferred securities; and

~~[(G)]~~(H) offerings of [securities of closed-end companies as defined under Section (5)(a)(2) of] an investment company registered under the Investment Company Act of 1940.

(10) “Restricted person” means:

(A) Members or other broker/dealers;

(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;

(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, 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 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]. However, no such person shall be deemed a restricted person for purposes of determining whether

the account over which such person has investment authority is a restricted person;

(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] materially supports, or receives material support from, such person. However, the immediate family member shall not be deemed a restricted person for purposes of determining whether the account over which such person in subparagraph (D)(i) has investment authority is a restricted person.

Provided, however, that the term “restricted person” under this subparagraph (D) shall not include a person solely because he or she [is a participant] has investment authority in an investment club or a family [partnership] investment vehicle.

(E) Persons Owning a Broker/Dealer

(i) Any person listed, or required to be listed, in Schedule A of a Form BD (other than with respect to a limited business broker/dealer), except persons [with] identified by an ownership [interests] code of less than 10%;

(ii) any person listed, or required to be listed, in Schedule B of a Form BD (other than with respect to a limited business broker/dealer), except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A [with] identified by an ownership [interest] code 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, or required to be listed, in [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];] or other than with respect to a limited business broker/dealer;

(v) Any person that directly or indirectly owns 25% or more of a public reporting company listed, or required to be listed, in [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]) or other than with respect to a limited business broker/dealer).

(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.