CHX's jurisdiction,[18] the proposal also will facilitate the CHX's oversight of such persons by ensuring that the CHX has the authority to enforce its rules and the federal securities laws against such persons.

The CHX's proposal also protests investors and the public interest by noting that a person characterized as an independent contractor must register with the CHX if he or she falls within the definition of registered person. This position is consistent with the 1982 Letter,[19] which stated, among other things, that an independent contractor salesperson whose activities are subject to control by a broker-dealer must be registered with a SRO. By providing a clear statement of the CHX's policy regarding the registration of independent contractors, the CHX's proposal should help to ensure that independent contractors who come within the CHX's definition of registered person register with the CHX.

CHX Article VI, Rule 2(c), ''Person Exempt from Registration,'' provides exemptions from registration for associated persons who functions are solely and exclusively clerical or ministerial or who are not actively engaged in the securities business.[20] The Commission notes that the rules of the National Association of Securities Dealers, Inc. (''NASD'') also provide these exemptions from registration.[21] Accordingly, the Commission believes that these exemptions from registration are reasonable and raise no new regulatory issues.

New CHX Article VI, Rule 2(d), ''Other Registration Requirements,'' prohibits members from making application for the registration of any associated person when there is no intent to employ such person in the member's securities business. NASD Rule 1031(a) also contains this prohibition. Accordingly, the Commission believes that this provision of the CHX's proposal is reasonable and raises no new regulatory issues.

The Commission believes that it is reasonable for the CHX to amend Interpretation and Policy .01 to indicate that amendments to Forms U–4 and BDA regarding any registered person must be submitted to the CHX within 30 days after the registered person learns the facts or circumstances requiring the forms to be revised, or, if the amendment involves a statutory disqualification, as defined in the Act, within 10 days after the disqualification occurs.[22] The Commission notes that the rules of the NASD contain a similar provision.[23] Accordingly, the Commission believes that the CHX's amendment to Interpretation and Policy .01 is reasonable and raises no new regulatory issues.

The Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 clarifies new CHX Article VI, Rule 2(b) by indicating that members, as well as associated persons, are registered persons under CHX Article VI, Rule 2(b). This change reflects the inclusion of sole proprietors within CHX Article VI, Rule 1(b)'s enumerated list of registered persons and eliminates an inconsistency that would arise if the CHX defined registered persons to include only persons associated with members and member organizations. Amendment No. 3 strengthens the CHX's proposal by requiring the filing of amendments to Forms U–4 and BD that involve a statutory disqualification within 10 days after the statutory disqualification occurs. Accordingly, the Commission believes that it is consistent with Sections 6 and 19(b) of the Act to approve Amendment Nos. 2 and 3 on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any persons, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to file number SR–CHX–98–06 and should be submitted by June 16, 1998.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[24] that the proposed rule change (SR–CHX–98–06) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[25]

[FR Doc. 98–13816 Filed 5–22–98; 8:45 am]

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[18] Registered persons submit to the authority of the organizations or states to which they apply for registration on the Form U–4.

[19] *See* 1982 Letter, *supra* note 9.

[20] As noted above, persons in this category may include, for example, for example, senior officers in a division of a broker-dealer that does not participate in the member's securities business. *See* March 13 Conversation, *supra* note 10.

[21] *See* NASD Rule 1060(a)(1) and (2).

[22] *See* Amendment No. 3, *supra* note 6.

[23] See NASD By-Law Article V, Section 2(c).

[24] 15 U.S.C. 78s(b)(2).

[25] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40001; File No. SR–NASD–97–95]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change By the National Association of Securities Dealers, Inc. Relating to Amendments to the Free-Riding and Withholding Interpretation

May 18, 1998.

I. Introduction

On December 23, 1997,[1] the National Association of Securities Dealers Regulation, Inc. (''NASD Regulation'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[2] and Rule 194–b thereunder.[3] Notice of the proposal appeared in the **Federal Register** on February 11, 1998.[4] The Commission received one comment letter regarding the proposal.[5] The

[1] On March 12, 1998, NASD Regulation filed Amendment No. 1 to the proposal. Amendment No. 1 revised Paragraph (b)(9)(A)(ii) to include the shares of a member's parent that are publicly traded on an exchange or Nasdaq in the exemption granted for shares of members traded on an exchange or Nasdaq. Section III of this approval order contains a further discussion of this amendment. In brief, the technical amendment was necessary to reflect the fact that members are often part of a holding company structure wherein the parent of the member is the entity that actually trades on an exchange or Nasdaq. Amendment No. 1 also corrected a drafting error in the original proposal's Paragraph (d) of IM–2110–1 to clarify that both employees and directors may take advantage of an exemption for issuer directed securities programs. Because this amendment is technical the statute does not require that it be published for comment.

[2] 15 U.S.C. 78s(b)(1).

[3] 17 CFR 240–19b–4.

[4] Securities Exchange Act Release No. 39620 (February 4, 1998), 63 FR 7026 (February 11, 1998).

[5] *See* letter from Sullivan & Cromwell to Jonathan G. Katz, Secretary, SEC, dated March 13, 1998.

commenter generally supported the proposed rule change with some modifications.[6]

The proposal amends Interpretative Material IM–2110–1 and Rule 2720 to revise certain aspects of the Free-Riding and Withholding Interpretation (''Interpretation''). The purpose of the Interpretation is to protect the integrity of the public offering system by ensuring that members make a bona fide public distribution of ''hot issue'' securities and do not withhold such securities for their own benefit or use the securities to reward other persons who are in a position to direct future business to the member. Hot issues are defined by the Interpretation as securities of a public offering that trade at a premium in the secondary market whenever such trading commences.

The Interpretation prohibits members from retaining the securities of hot issues in their own accounts and prohibits members from allocating such securities to directors, officers, employees and associated persons of such members and other broker-dealers. It also restricts member sales of hot issue securities to the accounts of specified categories of persons, including, among others, senior officers of banks, insurance companies, registered investment companies, registered investment advisory firms and any other person with such organizations whose activities influence or include the buying and selling of securities. These basic prohibitions and restrictions are also made applicable to sales by members of hot issue securities to accounts in which any such persons may have a beneficial interest and, with some exceptions, to members of the immediate family of those persons restricted by the Interpretation.

In March 1997, the NASD Regulation Board of Directors (''Board''), acting upon recommendation from the National Business Conduct Committee (''NBCC'')[7] considered various amendments to the Interpretation. The Board submitted a series of proposed rule amendments to the membership for comment in Notice to Members 97–30. NASD Regulation received 22 comment letters in response to Notice to Members 97–30. As described below, the proposal has been amended in response to these comments.

II. Summary Description of the Proposed Rule Change

A. Exemptive Authority

Previously, there has not been a provision in the Interpretation itself to allow the NBCC, the Board, or NASD Regulation staff to grant exemptive relief. In the past, the NBCC, relying on the NASD By-Law's grant of authority to the Board and its Committees, granted exemptions in certain unique circumstances. NASD Rule 9600 delegates exemptive authority in the Interpretation to the Office of General Counsel. The Interpretation previously provided for exemption relief solely in cases involving sales of issuer-directed securities to non-employee-director restricted persons pursuant to Paragraph (d)(2) of the Interpretation.

As revised, the Interpretation authorizes NASD Regulation staff, upon written request and taking into consideration all relevant factors, to provide an exemption either unconditionally or on specified terms from any or all of the provisions of the Interpretation, consistent with the purposes of the Interpretation, the protection of investors and the public interest. The proposed rule revisions also provide that persons may appeal decisions of NASD Regulation staff to the National Adjudicatory Council.

B. Treatment of Direct and Indirect Owner of Broker-Dealers

In 1994, the Interpretation's definition of ''associated person'' was amended to exempt certain passive investors in broker-dealers.[8] Among other things, the rule amendments approved in the instant filing address two limitations from the previous amendments. First, the definition of associated person as previously provided in the Interpretation did not include non-natural persons that have an ownership interest in or have contributed capital to a broker-dealer. Secondly, the Interpretation did not affirmatively specify any ownership levels at which a natural person becomes an associated person by reason of his or her ownership interest in a broker-dealer. Rather, the Interpretation only specified when a natural person is not an associated person.

In Notice to Members 97–30, NASD Regulation proposed creating a new definition of ''restricted person.'' Among other things, commenters advised the NASD that this approach would result in confusion because the term ''restricted person'' was already used throughout the Interpretation. Commenters also observed that when the proposed restricted persons provisions were read with other sections of the Interpretation, the Interpretation would appear to be so broad as to preclude purchases by any entity that owns 10 percent or more of a broker-dealer or any account in which such entity has a beneficial interest.

Having considered the potential problems with creating a new definition of ''restricted person,'' to clarify the application of the Interpretation to natural and non-natural persons, the Interpretation has been revised by NASD Regulation to create a new Paragraph (b)(9) of IM 2110–1. Paragraph (b)(9)(A) would exempt from the Interpretation's prohibitions purchases by any person who directly or indirectly owns any class of equity securities of, or who has made a contribution of capital to, a member, and whose ownership or capital interest is passive and is less than 10 percent of the equity or capital of a member, as long as such person purchases hot issues from a person other than the member in which it has such passive ownership and such person is not in a position by virtue of its passive ownership interest to direct the allocation of hot issues.

Alternatively, a second exemption embodied in Paragraph (b)(9)(A) would exclude purchases by any person who directly or indirectly owns any class of equity securities of, or who has made a contribution of capital to, a member, and whose ownership or capital interest is passive and is less than 10 percent of the equity or capital of a member, as long as such member's shares, or shares of a parent of such member, are traded on an exchange or Nasdaq.

In response to commenters' concerns that the rule revisions proposed in Notice to Members 97–30 would prohibit sales of hot issues to all entities within many insurance companies that own a broker-dealer, Paragraph (b)(9)(B) of the proposal exempts sales of hot issues to any account established for the benefit of bona fide public customers of a person restricted pursuant to Paragraph (b)(9). This exception expressly notes that such accounts would include, but are not limited to, an insurance company's general or separate accounts.

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[6] On April 9, 1998. NASD Regulation filed Amendment No. 2 to the proposal. *See* letter to Katherine A. England, Assistant Director, Division of Market Regulation. Amendment No. 2 responds to the comment letter submitted by Sullivan and Cromwell regarding the proposed rule change. NASD Regulation's response to the comment letter is discussed in detail in Section III of this approval order. Because this amendment is technical the statute does not require that it be published for comment.

[7] The name of this committee has been changed to National Adjudicatory Council. *See* Securities Exchange Act Release No. 39470 (December 19, 1997), 62 FR 67927 (December 30, 1997).

[8] Securities Exchange Act Release No. 35059 (December 7, 1994), 59 FR 64455, 64457 (December 14, 1994).

Finally, Paragraph (b)(9)(C) retains the indirect ownership provisions originally proposed in Notice to Members 97–30. Specifically, it provides that any person with an equity ownership or capital interest in an entity that maintains an investment in a member shall be deemed to have a percentage interest of the entity of the member multiplied by the percentage interest of such person in such entity.

C. Exception to the Public Offering Definition

Heretofore, debt offerings have been included in the Interpretation's definition of ''public offering.'' The proposed rule change would provide an exception from the Interpretation for debt securities other than debt securities convertible into common or preferred stock. This exclusion is based upon the rationale that such offerings do not raise the same issues as equity offerings inasmuch as the price for a particular debt security generally fluctuates based on interest rate movements rather than demand factors. The definition of public offering also would except financing instrument-backed securities that are rated by a nationally recognized statistical rating organization in one of the four highest generic rating categories. Lastly, NASD Regulation has reconsidered its earlier position and, in response to comment letters received regarding Notice to Members 97–30, revised the term public offering so as to exclude secondary offerings by an issuer whose securities are actively traded securities. The modified Interpretation defines actively traded securities to include securities that have a worldwide average daily trading volume value of at least $1 million and are issued by an issuer whose common equity securities have a public float value of at least $150 million.

D. Foreign Mutual Funds

Purchases of shares of investment companies registered under the Investment Company Act of 1940 were previously exempt from the Interpretation based upon the rationale that the interest of any one restricted person in an investment company ordinarily is de minimis and because ownership of investment company shares generally is subject to frequent turnover. The proposed rule revisions would extend this rationale to the purchase of shares of foreign investment companies and thus exempt such shares from the Interpretation, subject to verification procedures designed, among other things, to ensure that the company is listed on a foreign exchange or authorized for sale to the policy by a foreign regulatory authority.

E. Issuer-Directed Share Exemption

In Notice to Members 97–30, NASD Regulation stated that persons have requested that the language of Paragraph (d) of the Interpretation be modified to clarify that the exemption is available to employees of the issuer who are materially supported by a restricted person and both employees and non-employee directors. Based upon the comments received and its own initiative to clarify and streamline the issuer-directed securities provisions more generally, the proposed rule change modifies Paragraph (d) of the Interpretation to permit persons associated with a member and their immediate family members to purchase hot issues. The amendments clarify that the exemptions apply to employees and directors of a parent or subsidiary of the issuer, consistent with NASD Regulation's past practice.

F. Accounts for Qualified Plans Under the Employment Retirement Income Security Act (''ERISA'')

The Interpretation has not previously expressly addressed the status of qualified employee benefit plans under ERISA. In direct response to the requests of commenters, the proposed rule change clarifies the status of such accounts. To that end, the proposal incorporates within the Interpretation itself a prior NBCC interpretation governing the matter. As a general rule, NASD Regulation believes qualified ERISA plans should not be deemed an ''investment partnership or corporation'' and should not be considered a ''restricted account'' for purposes of the Interpretation. The proposed amendments to the Interpretation provide guidance, however, in determining the factual circumstances wherein a qualified ERISA plan could be deemed restricted.

III. Comments Letters Received and Amendment No. 2 to the Proposal

As noted above, the Commission received one comment letter from Sullivan and Cromwell. Amendment No. 2 to the filing responds to the comment letter and, as discussed below, amends the proposal to address issues raised by the Sullivan and Cromwell letter.

A. Investment Grade Securities

The proposed rule change exempts from the Interpretation debt securities (other than debt securities convertible into common or preferred stock) and financing instrument backed-securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories. Sullivan and Cromwell recommends that NASD Regulation exempt ''investment grade preferred securities,'' (*i.e.*, preferred equities) from the Interpretation based upon its understanding that prices for such securities are principally based on prevailing interest rates and that many investors view investment grade preferred securities of different issuers as being largely fungible.

NASD Regulation does not agree with Sullivan and Cromwell that ''investment grade preferred securities'' should be excluded from the Interpretation, because NASD Regulation does not believe that the prices of investment grade preferred securities are based on interest rate movements to the same extent as investment grade debt. NASD Regulation believes that demand-side factors play an important role in the price of many preferred securities. In addition, preferred securities generally differ from investment grade debt in that they are rarely collateralized. Moreover, purchasers of preferred securities often look to the issuer's business and management in determining whether to purchase the security. For these reasons, NASD Regulation believes that ''investment grade preferred securities'' should not be excluded from the Interpretation. Amendment No. 2 to the filing states, however, that NASD Regulation will evaluate the impact of excluding investment grade debt and investment grade financing-backed securities from the Interpretation and will consider in the future whether preferred equities should also be excluded.

B. Paragraph (b)(9) and Direct/Indirect Owners of Broker-Dealers

In Paragraph (b)(9) of the proposed rule change, NASD Regulation prohibits members from selling hot issues to any person or to a member of the immediate family of such person who owns or has contributed capital to a broker-dealer, other than solely a limited business broker-dealer as defined in Paragraph (c) of the Interpretation, or the account in which any such person has a beneficial interest, with certain exceptions for ownership interest of less than 10%. Importantly, however, Paragraph (b)(9) exempts sales to the account of a restricted person that is established for the benefit of bona fide public customers.

The Sullivan & Cromwell letter makes a number of particularized comments, which are discussed in detail below. The thrust of Sullivan & Cromwell

comments is that Paragraph (b)(9) should be revised to apply only to institutions that are ''principally engaged in the broker-dealer business.'' In responding to the suggestion, NASD Regulation notes that it has rejected this argument many times and continues to believe that such a narrow approach is inconsistent with the scope and intent of the Interpretation. As reiterated in Amendment No. 2 to the filing, NASD Regulation is of the opinion that the proposed revisions by Sullivan and Cromwell would leave open a substantial possibility of reciprocal self-dealing among broker-dealer and owners of broker-dealers.

NASD Regulation notes that the Interpretation protects the integrity of the public offering process by ensuring that members make a bona fide public distribution at the public offering price of hot issue securities and do not withhold such securities for their own benefit or use such securities to reward other persons in the financial services business who are in a position to direct future business to the member. NASD Regulation believes the Interpretation also ensures that members of the securities industry do not take advantage of their inside position in the industry to the detriment of public investors. In light of the foregoing rationales, NASD Regulation believes that persons who own a significant percentage of a broker-dealer, *i.e.*, 10% or more, should be restricted under the Interpretation.

NASD Regulation notes that it has provided an exemption from the interpretation for persons that own 10% or more of a broker-dealer by permitting such persons to purchase hot issues for the benefit of bona fide public customers, or for an ERISA account pursuant to Paragraph (f)(3). NASD Regulation does not believe that permitting such persons to purchase hot issues for proprietary accounts, even if such hot issues directly or indirectly benefit some public shareholder, is consistent with the purposes of the Interpretation.

1. Banks and Industrial Companies with Broker-Dealer Subsidiaries and Affiliates

Sullivan and Cromwell states in its letter that it is concerned that the proposed rule change would affect the public offering market by making hot issues unavailable to many institutional customers, and in particular, banks with broker-dealer subsidiaries and affiliates. Sullivan and Cromwell observes that proposed Paragraph (b)(9) generally would prohibit the sale of hot issues to banks with broker-dealer subsidiaries and affiliates. To the extent that these banks purchase hot issues on a proprietary basis, NASD Regulation believes that the Interpretation should apply. NASD Regulation notes, however, that banks with broker-dealer subsidiaries and affiliates may purchase hot issues on behalf of bona fide public customers, pursuant to the exemption set forth in Paragraph (b)(9).

The proposed rule change also would prohibit industrial companies that own broker-dealers, such as General Electric Company (''GE'') and Ford Motor Company (''Ford'') from purchasing hot issues for their own account. Here again, NASD Regulation believes that this is the correct result. However, companies such as GE and Ford would be able to purchase hot issues for an account in which they have a beneficial interest, provided that such account is established for the benefit of bona fide public customers.

2. Accounts Established for the Benefit of Bona Fide Public Customers

As stated above, Paragraph (b)(a) of the proposed rule change contains an exemption for sales to the account of any person restricted under this subparagraph that is established for the benefit of bona fide public customer. Specifically, Paragraph (b)(9) states that such accounts would include ''insurance company general and separate accounts.'' NASD Regulation included these examples because it understood that investments from such accounts are passed on directly to policy holders, *i.e.*, bona fide public customers.

The Sullivan and Cromwell letter suggests that the exemption for accounts established for the benefit of bona fide public customers applies solely to life insurance companies. As explained by NASD Regulation, it was not intended that the exemption described in Paragraph (b)(9) apply solely to life insurance companies. NASD Regulation intended that the exemption apply across all industries. Accordingly, Paragraph (b)(9)(B) of the proposed rule change has been amended. The revised language is set forth below. Additions to the provision are italicized. Language to be deleted appears in brackets.

This prohibition shall not apply to sales to the account of any person restricted under this paragraph established for the benefit of bona fide public customers, including [an] insurance company general [or] , separate *and investment* accounts *and bank trust accounts.*

3. Shares of a Member Traded as Part of a Holding Company

As originally proposed, Paragraph (b)(9) of the proposed rule change would exempt any person who owns any class of equity securities of, or who has made a contribution of capital to, a member, and whose ownership or capital interest is passive and is less than 10% of the equity or capital of a member, so long as such member's shares are publicly traded on an exchange or Nasdaq. Sullivan & Cromwell states that this exemption does not properly reflect the fact that many of the largest broker-dealers are subsidiaries of publicly traded holding companies and are not themselves publicly traded. NASD Regulation previously addressed this issue in Amendment No. 1 to the filing. Amendment No. 1 revises paragraph (b)(9)(A)(ii) to include within the exemption shares of a parent of a member firm that are publicly traded on an exchange or Nasdaq.

4. Immediate Family Members

Paragraph (b)(9) applies to ''any person, or to a member of the immediate family of such person.'' Sullivan and Cromwell states that Paragraph (b)(9) would require a member, for example Merrill Lynch, to confirm not only that its customer does not own any Merrill Lynch Parent stock, but also that none of his or her immediate family members owns any such stock. Sullivan and Cromwell also states that Paragraph (b)(9) does not exempt immediate family members who are not materially supported by the restricted person, as does Paragraph (b)(2) of the Interpretation. Sullivan and Cromwell maintains that it would be almost impossible for a broker-dealer owned by a publicly traded holding company to comply with Paragraph (b)(9) since, on its face, it would require the broker-dealer to obtain complete information regarding the securities portfolios of each of its customers' immediate family members. Proposed Paragraph (b)(9), however, is implicated only by persons who own 10% or more of a member. Nevertheless, NASD Regulation believes that the provisions regarding the immediate family members of restricted persons under proposed Paragraph (b)(9) should not be more restrictive than the provisions in Paragraph (b)(2), which pertain to associated persons of a member. NASD Regulation has therefore amended Paragraph (b)(9) so as to exclude immediate family members who are not materially supported by restricted persons. Revised

Paragraph (b)(9) is set forth below. New language is italicized.

Sell any of the securities to any person, or to a member of the immediate family of such person *who is supported directly or indirectly to a material extent by such person,* * * *.

5. Miscellaneous Changes to Paragraph (b)(9)

Pursuant to Amendment No. 2, NASD Regulation also corrected an inadvertent clerical error in Paragraph (b)(9)(C) of the proposed rule change that was identified by the Sullivan and Cromwell comment later. The missing language set forth below was contained in the proposed rule change as published in NASD Notice to Members 97–30, but was omitted from the rule filing. New language is italicized. Revised Paragraph (b)(9)(C) has been amended to read as follows:

For purposes of this paragraph, any person with an equity ownership or capital interest in an entity that maintains an investment in a member shall be deemed to have a percentage interest *in the member equal to the percentage interest* of the entity in the member multiplied by the percentage interest of such person in such entity.

C. Foreign Investment Companies

Paragraphs (f) and (1)(6) of the proposed rule change would exempt foreign investment companies *i.e.*, foreign mutual funds, organized under the laws of the foreign jurisdiction, that have provided to the member a written certification prepared by counsel or an independent certified public accountant, which states that: (1) The fund has 100 or more investors; (2) the fund is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority, (3) no more than 5% of the fund assets are to be invested in the hot issue securities being offered, and (4) any person owning more than 5% of the shares of the fund is not a restricted person.

Sullivan and Cromwell states that while it agrees that an exemption should be provided for foreign investment companies, it opposes any requirement that NASD members obtain written certification from an attorney or accountant. Sullivan and Cromwell proposes instead that NASD Regulation exempt foreign investment companies based upon their ''status'' under foreign regulatory regimes, for example, any fund qualified for sale under the European Union's Directive on Undertakings for Collective Investment in Transferable Securities.

In response to comments received regarding Notice to Members 97–30, and to alleviate the burdens associated with the written certification requirement, NASD Regulation modified proposed Paragraph (1)(6) to permit foreign, and not just U.S., attorneys and accountants to provide written certifications. NASD Regulation continues to believe, however, that written certifications are an appropriate method of determining whether a particular foreign investment company meets the criteria for exemption from the Interpretation and does not agree that this requirement should be eliminated.

Sullivan and Cromwell states in its comment letter that if written certifications are to be required, it recommends two changes. First Sullivan and Cromwell states that foreign investment companies, like registered investment companies, do not investigate the status of their shareholders and thus will be unable to comply with the requirement to certify that ''any person owning more than 5% of the shares of the fund is not a person described in Paragraphs (b)(1), (2), (3), or (4) of the Rule.''

NASD Regulation considered this issue in proposing the exemption for foreign investment companies but concluded that the concerns of the Interpretation that restricted persons do not indirectly purchase hot issues through foreign investment companies were paramount. Accordingly, if a foreign investment company is owned more than 5% by a person, an attorney or accountant must certify that such person is not a restricted person under the Interpretation. The attorney or accountant providing the written certification required pursuant to paragraph (1)(6) may rely upon information supplied by the foreign investment company and any shareholder that owns more than 5% of the foreign investment company. NASD Regulation is of the opinion that the shareholder is likely to cooperate with any request by the foreign investment company, or its counsel or accountant, regarding the shareholder's status under the Interpretation since the shareholder's cooperation may enhance the foreign investment company's investment opportunities by permitting it to invest in hot issues. As a practical matter, however, the requirement to determine whether a more than 5% shareholder is a restricted person is unlikely to affect many foreign investment companies because, as Sullivan and Cromwell concedes in its comment letter, each foreign investment company must have at least 100 shareholders and, consequently, it is unlikely that the interest of any one person will exceed the 5% threshold.

Second, Sullivan and Cromwell states that, as drafted, Paragraph (1)(6) of the Interpretation would require a member firm to obtain a written certification prior to each hot issue sale to a foreign investment company. Sullivan and Cromwell views this as unduly burdensome and recommends that NASD Regulation revise Paragraph (1)(6) to be consistent with Paragraph (f)(2), which states that ''a written representation shall be deemed to be current if it is based upon the status of the account as of a date more than 18 months prior to the date of the transaction.'' NASD Regulation agrees that members should not be required to obtain a written certification before each transaction and will adopt the same standard in effect for certifications made pursuant to Paragraph (f)(2). Accordingly, the final sentence of Paragraph (f)(2) of the Interpretation shall be amended as set forth below. New language is italicized.

For purposes of this paragraph (f) *and the certification required pursuant to paragraph (1)(6).* a list or written representation shall be deemed to be current if it is based upon the status of the account as of a date not more than 18 months prior to the date of the transaction.

In addition to responding to the Sullivan and Cromwell observations, Amendment No. 2 corrected proposed Paragraph (1)(6)(D) to make the paragraph clearer and more consistent with other parts of the Interpretation. The revised paragraph is set forth below. New language is italicized. Language to be deleted from the paragraph appears in brackets.

Any person owning more than 5% of the share of *the* fund is not a *restricted* person *as* described in paragraph (b)(1), (2), (3), [or] (4) *or (9)* of the [Rule] *interpretation.*

D. Secondary Distributions

The proposed rule change exempts from the Interpretation secondary distributions by an issuer whose securities are actively-traded securities. Sullivan and Cromwell supports the decision to exempt secondary offerings but objects to the provision in the definition of ''actively-traded securities'' that excludes securities issued by the distribution participant or an affiliate of the distribution participant. NASD Regulation's proposed rule change to exempt secondary offerings was drafted to track the exemption for actively-traded securities set forth in the SEC's Regulation M. In adopting the exemption for secondary distributions, NASD Regulation was focusing on the average daily trading value and public float value provisions of Regulation M exempt securities. NASD Regulation agrees with Sullivan and Cromwell concerning secondary offerings of

members or affiliates of members and proposes revising the definition of ''actively-traded securities'' to extend the exemption to securities issued by a distribution participant or an affiliate of the distribution participant. Paragraph (1)(7)(A), as amended, is set forth below. Language to be deleted from the paragraph appears in brackets.

Actively-traded securities means securities that have an ADTV value of at least $1 million and are issued by an issuer whose common equity securities have a public float value of at least $150 million[; provided, however, that such securities are not issued by the distribution participant or an affiliate of the distribution participant].

Finally, Sullivan Cromwell notes that Paragraph (l)(1) refers to secondary distributions ''by an issuer.'' Sullivan and Cromwell asks whether secondary distributions by an existing security holder are subject to the Interpretation. If not, Sullivan and Cromwell recommends amending the text of proposed Paragraph (l)(1) to extend the exemption to such distributions. NASD Regulation did not intend to exclude from the exemption secondary offerings by security holders. Accordingly, it has revised Paragraph (l)(1) as set forth below. New language is italicized. Language to be deleted from the paragraph appears in brackets.

The term public offering shall exclude secondary distributions by an issuer *or any security holder of the issuer, of* [whose securities are] actively-traded securities.

IV. Conclusion

The Commission has carefully considered the comments set forth in the Sullivan and Cromwell letter. As discussed in detail above, the NASD Regulation has made a number of technical amendments to the proposal in response to the Sullivan and Cromwell letter, which the Commission believes are consistent with the spirit of the Interpretation. Indeed, the Commission believes the changes to the proposal which were made pursuant to Amendment No. 1 and No. 2 will facilitate the ability of NASD member firms to comply with the Interpretation, because the amendments further clarify the intent of the proposed rule change. For example, in response to the Sullivan and Cromwell letter, the Interpretation was amended to clarify that the exemption in paragraph (b)(9)(B) for sales to the accounts of restricted persons established for the benefit of bona fide public customers was intended to apply across all industries, as opposed to life insurance companies exclusively. Similarly, Amendment No. 1 to the proposal facilitates member firm compliance by amending the paragraph (b)(9)(A)(ii) exemption for shares of a member traded on an exchange or Nasdaq to include an exemption for shares of a member traded as a part of a holding company. This amendment fosters member firm compliance with the Interpretation by recognizing that many of the largest broker-dealers are subsidiaries of publicly traded holding companies and are not themselves publicly traded.

NASD Regulation has determined not to revise the proposal in response to Sullivan and Cromwell's suggestion that paragraph (b)(9) of the Interpretation, which with certain exceptions, prohibits sales of hit issue securities to any person who owns or has contributed capital to a broker-dealer, be revised such that it only applies to institutions engaged ''principally in the broker-dealer business.'' The Commission agrees with NASD Regulation that such an amendment is inconsistent with the scope and intent of the proposal, because the modification would leave open a substantial possibility of self-dealing between broker-dealers and owners of broker-dealers. Accordingly, the Commission believes NASD Regulation has a sound investor protection basis for its decision not to narrow the scope of paragraph (b)(9) of the Interpretation as requested by Sullivan and Cromwell.

The Commission believes the proposed rule change, as amended, is consistent with the provisions of section 15(A)(b)(6) of the Act,[9] which provides in pertinent part that the rules of a national securities association be designed to prevent fraudulent and manipulative acts, promote just and equitable principles of trade and protect investors and the public interest. Specifically, the proposal preserves public confidence in the fairness of the investment banking and securities business by ensuring that members of the investment banking community do not unfairly benefit from public offerings by virtue of their positions as insiders, to the detriment of public investors. Preservation of investor confidence in the fairness of the markets is critical to the continued participation of all classes of securities marked participants. The Commission believes, moreover, that the proposed rule change is consistent with section 15A(b)((9) [10] in that it will alleviate certain inequities caused by the Interpretation, which imposed burdens on competition not necessary or appropriate in furtherance of the purposes of the Act.

In approving this proposal, the Commission notes that it is has considered the proposal's impact on efficiency, competition, and capital formation.[11] The Commission believes the proposal will facilitate the capital raising process by removing restrictions and compliance burdens imposed by the Interpretation with respect to certain transactions where application of the Interpretation does not enhance investor protection or the public interest. For example, the proposal excludes from the definition of public offering secondary offerings by an issuer whose securities are actively traded securities. At the same time, the Interpretation continues to apply to those securities allocations that pose a risk of undercutting the Interpretation's objective of ensuring a bona fide distribution of hot issue securities to the public.

It is therefore ordered, pursuant to Section 19(b)(2) [12] of the Act, that the proposed rule change SR–NASD–97–95 be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–13850 Filed 5–22–98; 8:45 am]

BILLING CODE 8010–01–M

[9] 15 U.S.C. 78*o*-3.

[10] 15 U.S.C. 78o-3.

[11] 15 U.S.C. 78c(f).

[12] 15 U.S.C. 78s(b)(2).

[13] 17 CFR 200.30–3(a)(12).

SMALL BUSINESS ADMINISTRATION

Notice of Action Subject to Intergovernmental Review Under Executive Order 12372

AGENCY: U.S. Small Business Administration.

ACTION: Notice of Action Subject to Intergovernmental Review Under Executive Order 12372.

SUMMARY: The Small Business Administration (SBA) is notifying the public that it intends to grant the pending applications of 22 existing Small Business Development Centers (SBDCs) for refunding on October 1, 1998, subject to the availability of funds. Four states do not participate in the EO 12372 process, therefore, their addresses are not included. A short description of the SBDC program follows in the supplementary information below.

The SBA is publishing this notice at least 90 days before the expected refunding date. The SBDCs and their mailing addresses are listed below in the addresses section. A copy of this notice also is being furnished to the