

Notice to Members

DECEMBER 2003

SUGGESTED ROUTING

Corporate Financing
Institutional
Legal & Compliance
Operations
Senior Management
Syndicate
Trading & Market Making
Training

KEY TOPICS

Free-Riding and Withholding
IPOs
Issuer Directed Securities
Restricted Person
Rule 2790

INFORMATIONAL

Initial Public Offerings (IPOs)

SEC Approves New Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities); Replaces Free-Riding and Withholding Interpretation; **Voluntary Effective Date: December 23, 2003; Mandatory Effective Date: March 23, 2004**

Executive Summary

On October 24, 2003, the Securities and Exchange Commission (SEC) approved new Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities), which replaces the Free-Riding and Withholding Interpretation (IM-2110-1).¹ As described in detail below, Rule 2790 generally prohibits a member from selling a "new issue" to any account in which a "restricted person" has a beneficial interest. The term "restricted person" includes most associated persons of a member, most owners and affiliates of a broker/dealer, and certain other classes of persons. The Rule requires that a member, before selling a new issue to any account, meet certain "preconditions for sale," which generally require the member to obtain a representation from the beneficial owner of the account that the account is eligible to purchase new issues in accordance with the Rule. The Rule also contains a series of general exemptions.

In view of the number of significant changes under the Rule, NASD has agreed to provide a three-month transition period in which members and associated persons may comply with either Rule 2790 or the Interpretation. Thus, through the period ending **March 22, 2004**, members and associated persons may comply with either the Rule or the Interpretation. Effective **March 23, 2004**, all members and associated persons must comply with Rule 2790.

03-79

The SEC Approval Order, which includes the text of the Rule, is available at http://www.nasdr.com/pdf-text/rf99_60_app.pdf.

Questions/Further Information

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8104; or Afshin Atabaki, Attorney, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8902.

Background and Discussion

Rule 2790, like the Free-Riding and Withholding Interpretation (Interpretation) it replaces, is designed to protect the integrity of the public offering process by ensuring that: (1) NASD members make *bona fide* public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including NASD members and their associated persons, do not take advantage of their “insider” position to purchase “new issues” for their own benefit at the expense of public customers. The Rule plays an important part in maintaining investor confidence in the capital raising and public offering process.²

Rule 2790 represents a significant restructuring and revision to the Interpretation. While the focus of this *Notice* is on the provisions of new Rule 2790, it is worth noting some of the more significant changes from the Interpretation. First, the Rule eliminates the requirement that an offering must be a “hot issue,” which is defined in the Interpretation as securities of a public offering that trade at a premium in the secondary market whenever such secondary market beings. To avoid some of the problems arising from the fact that members could not always predict whether an offering would be a hot issue, the prohibitions in Rule 2790 apply to all new issues, regardless of whether they commence trading in the secondary market at a premium.

Second, Rule 2790 eliminates the category of “conditionally restricted” persons. Under the Interpretation, persons generally referred to as “conditionally restricted” were eligible to purchase hot issues if certain conditions were met, including that the purchases were in accordance with the purchaser’s “normal investment practice.” NASD Rule 2790 instead more narrowly defines the category of restricted persons, but does not provide exemptions based on a person’s individual circumstances.

Third, Rule 2790 adopts a “*de minimis*” exemption, allowing an account that is beneficially owned in part by restricted persons to purchase new issues if the beneficial interests of such persons do not exceed 10 percent of such account. By contrast, the Interpretation contains no such exemption, and thus even the most minute interests by a restricted person would prohibit an account from purchasing a hot issue unless certain “carve-out” and certification procedures were followed.

Fourth, the new Rule standardizes the records firms must maintain evidencing that sales to accounts are in accordance with the Rule. The Interpretation imposes varying certification requirements depending on whether an account is, for example, an investment partnership or corporation, a foreign investment company, an account for which a bank or trust company is acting as a conduit, or an account of a foreign broker/dealer (on behalf of non-restricted persons) that is participating in the distribution as an underwriter, etc.). Rule 2790 consolidates the recordkeeping requirements in a single section addressing “preconditions for sale.”

Finally, the Rule eliminates the cancellation provisions. Because the Interpretation applies only to hot issues, and it was not always known whether an offering would be a hot issue, the Interpretation contains a provision allowing a member within a specified time period to cancel an allocation to a restricted person and reallocate such shares to a non-restricted person. In view of the fact that Rule 2790 applies to all new issues, not just those that are “hot,” this provision was deemed unnecessary.

A. General Prohibitions

Paragraph (a) sets forth the general prohibitions of the Rule. Subparagraph (a)(1) states that 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 by the Rule. Subparagraph (a)(2) provides that 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 by the Rule. Subparagraph (a)(3) provides that a member may not continue to hold new issues acquired by the member as an underwriter, selling group member,³ or otherwise, except as permitted by the Rule.

Subparagraph (a)(4) sets for exceptions to the general prohibitions. Subparagraph (a)(4)(A) permits sales or purchases from one member of the selling group to another member that are incidental to the distribution of a new issue to a non-restricted person at the public offering price. Subparagraph (a)(4)(B) permits “accommodation sales”—sales to or purchases by a broker/dealer at the public offering price to enable that broker/dealer’s customer to purchase a new issue at the public offering price. Lastly, subparagraph (a)(4)(C) is designed to exempt purchases by joint back office broker/dealers (“JBOs”⁴) that can fall within the *de minimis* exemption of paragraph (c)(4). NASD believes that the ability of hedge funds registered as JBOs (or with JBO subsidiaries) to purchase new issues should be determined by the status of the beneficial owners of the fund, not simply the fund’s status as a broker/dealer (or owner of a broker/dealer). Accordingly subparagraph (a)(4)(C) exempts purchases of a new issue at the public offering price by a broker/dealer (or owner of a broker/dealer) organized as an investment partnership, provided that such purchases are credited to the capital accounts of its partners in accordance with the provisions of paragraph (c)(4). This provision allows an investment partnership that registers as a broker/dealer, or that has a broker/dealer subsidiary, to purchase new issues on the same terms as other investment partnerships.⁵

B. Preconditions for Sale

Paragraph (b) provides that a member may not sell new issues to any account unless within the previous 12 months it has in good faith obtained a representation from either (1) the beneficial owners of the account, or a person authorized to represent the beneficial owners of an account, that the account is eligible to purchase new issues in accordance with the Rule, or (2) certain conduits (such as a bank, foreign bank, broker/dealer, or investment adviser) that all purchases of new issues are in compliance with the Rule. Paragraph (b) further provides that a member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. Paragraph (b) also sets forth the recordkeeping provisions applicable to the preconditions for sale.⁶

NASD requires the initial verification of an account's status under the Rule to be a positive affirmation from the beneficial owners, person authorized to act on their behalf, or a conduit. However, as noted in the Approval Order, NASD will permit members to conduct the annual verification of an account's status through the use of negative consent letters. Thus, a member may furnish a customer with account information on record used to determine that the account is eligible to purchase new issues and ask the customer to indicate whether anything has changed to make the account restricted. In the absence of any response from the customer, the member may continue to deem the account as non-restricted. In addition, NASD intends to permit the use of electronic communications in accordance with the standards adopted by the SEC and NASD for the use of such communications (e.g., where appropriate notice has been provided and where necessary customer consent has been obtained). Lastly, however, NASD will not permit members to verify customer account information orally.

During the rulemaking process, some commenters asked what type of representations would be required in a fund-of-funds context. NASD responded that under the Rule, a member only must obtain a representation from a person authorized to represent the beneficial owners of the fund/account that purchases new issues directly from the member ("master fund"). NASD expects, however, that any person making such a representation would need to ascertain the status of investors of any feeder funds that invest in the master fund. If a representative of a master fund is unable to ascertain the status of an investor in a feeder fund, the master fund must deem such feeder fund to be restricted and ensure that any profits from new issues are not allocated to that fund (or consider whether any exemption, such as the *de minimis* exemption, might apply to that feeder fund).

While the Rule specifies that a member must verify the status of the master fund annually, the Rule does not specify a time period during which a master fund may rely on information from a feeder fund. NASD recognizes that logistical impracticalities may prevent all authorized representatives of feeder funds from verifying information at the same time as the representative of the master fund. Thus, NASD will allow the representative of a master fund to rely on information from any feeder fund that is no more than 12 months old. Similarly, the representative of a feeder fund that in turn receives investments from other feeder funds may rely on information that is no more than 12 months old.

In addition, if a feeder fund is beneficially owned in part by restricted persons and seeks to avail itself of the *de minimis* exemption, the person authorized to represent that fund should specify the percentage ownership by restricted persons. An authorized representative of a master fund that invests directly in new issues will be responsible for aggregating interests of restricted persons from the feeder funds to ensure that the aggregate ownership by restricted persons does not exceed the 10 percent threshold.

C. General Exemptions

Rule 2790 contains a number of exemptions. Many of the exemptions in the Interpretation have been carried forward into Rule 2790. In some cases, new exemptions have been added, and in others, exemptions have been scaled back or eliminated entirely. The exemptions in Rule 2790 reflect the general proposition that sales to and purchases by entities that have numerous beneficial owners are generally not the type of transactions that the Rule should prohibit. Despite this general unifying theme, NASD emphasizes that it will not be sufficient for a member or purchaser to claim an exemption on the basis that a particular purchase or sale benefits numerous beneficial owners, few if any of whom are restricted persons. To purchase new issues under the Rule, an account otherwise restricted must be covered by a specific exemption under the Rule.

1. Subparagraph (c)(1) exempts from the Rule sales to and purchases by investment companies registered under the Investment Company Act of 1940. This provision is similar to an existing exemption in the Interpretation.
2. Subparagraph (c)(2) exempts sales to and purchases by common trust funds that have investments from 1000 or more accounts and that do not limit interests in the fund principally to trust accounts of restricted persons. This provision is a new exemption.
3. Subparagraph (c)(3) exempts insurance company general, separate, or investment accounts provided that (a) the account is funded by premiums from 1000 or more policyholders, or, if a general account, the insurance company has 1000 or more policyholders; and (b) the insurance company does not limit the policyholders whose premiums are used to fund the account principally to restricted persons, or, if a general account, the insurance company does not limit its policyholders principally to restricted persons. This provision also is a new exemption.
4. Subparagraph (c)(4) establishes the so-called "*de minimis*" exemption. The *de minimis* exemption exempts sales to and purchases by an account if the beneficial interests of restricted persons do not exceed in the aggregate 10 percent of such account. The *de minimis* exemption was created in part to reflect the burden of carving out interests of restricted persons that own only a small portion of a restricted account. NASD believes that allocations to accounts that are owned 90 percent or more by non-restricted persons generally do not present concerns underlying the Rule. While restricted persons may receive

some benefit from new issues, nearly all of the benefit (90 percent or greater) flows to non-restricted persons. The introduction of a *de minimis* exemption represents a substantial change from the Interpretation, which required all interests of restricted persons to be “carved-out” no matter how small.

In addition, the Rule provides more flexibility concerning the methods of effecting a “carve-out.” In paragraph (g) of the Interpretation, NASD specified the process for “carving-out” interests of restricted persons. Generally, this called for the creation of “separate brokerage accounts.” In administering these procedures, NASD staff observed that not all investment entities (and in particular funds of funds) were established in a manner to accommodate the specific procedures of paragraph (g), even though such accounts could just as effectively ensure that the benefits of IPOs did not reach restricted persons. In Rule 2790, NASD has eliminated specific “carve-out” procedures recognizing that there may be many effective means of segregating interests of restricted persons. Some investors may choose to establish “separate accounts” similar to the provisions of paragraph (g) of the Interpretation. Others instead may maintain one account but adjust the capital accounts of restricted persons to remove any gains (or losses) attributable to new issues.

For purposes of determining the ownership level of restricted persons in a master fund, the interests of restricted persons in a feeder fund shall be attributed to a master fund in an amount equal to the restricted persons’ interest in the feeder fund times the master fund’s interest in the feeder fund. For example, if a master fund has an equal interest in 10 feeder funds, 5 of which are owned 20 percent by restricted persons, and 5 of which are owned 5 percent by restricted persons, the master fund is deemed to be owned 12.5 percent by restricted persons. The interest of the master fund in the each of the 5 funds that are owned 20 percent by restricted persons is determined as follows: 10 percent (the interest of the master fund in the first tier feeder fund) x 20 percent (the interest of the first tier feeder fund in the second tier feeder fund) = 2 percent. With respect to these 5 funds owned by the master fund, the interest of restricted persons in aggregate is 10 percent (5 funds x 2 percent each). The interest of the master fund in the each of the 5 funds that are owned 5 percent by restricted persons is determined as follows: 10 percent (the interest of the master fund in the first tier feeder fund) x 5 percent (the interest of the first tier feeder fund in the second tier feeder fund) = 0.5 percent. With respect to these 5 funds owned by the master fund, the interest of restricted persons is 2.5 percent (5 funds x 0.5 percent each). The total interest of restricted persons in the master fund is 12.5 percent (10 percent + 2.5 percent = 12.5 percent). In this case, the master fund would not be eligible to use the *de minimis* exemption unless it reduced the interest of restricted persons from 12.5 percent to 10 percent or below.

-
5. Subparagraph (c)(5) establishes the “publicly traded entity exemption.” Specifically, subparagraph (c)(5) exempts sales to and purchases by publicly traded entities (other than a broker/dealer or an affiliate⁷ of a broker/dealer where such broker/dealer is authorized to engage⁸ in the public offering of new issues either as a selling group member or underwriter) that are listed on a national securities exchange, are traded on the NASDAQ National Market, or are foreign issuers that meet the quantitative designation criteria for listing on a national securities exchange or the NASDAQ National Market. NASD notes that these entities have broad public ownership and may be purchased by any investor. Moreover, the publicly traded entity exemption recognizes the practical limitations in attempting to identify every beneficial owner, and that the benefits of investments in new issues are, indirectly, shared by the public shareholders.

Thus, a parent company that is publicly traded and has a broker/dealer subsidiary that engages in public offerings would be restricted under paragraph (i)(10)(E) of the Rule and would not qualify for the publicly traded entity exemption. All accounts in which such parent company had a beneficial interest (including entities in which the parent held an interest of 10 percent or more) also would be restricted persons, even if the business of the subsidiaries was wholly unrelated to the broker/dealer activities. By contrast, a publicly traded parent company whose broker/dealer subsidiary does not engage in public offerings of new issues would qualify for the publicly traded entity exemption in paragraph (c)(5) of the Rule. The broker/dealer subsidiary would continue to be a restricted person, but the parent company and other non-restricted subsidiaries of the parent company would be eligible to purchase new issues.

By looking at whether a broker/dealer is authorized to engage in public offerings of new issues, NASD is excluding affiliates of “full service” broker/dealers. On the other hand, Rule 2790 allows purchases of new issues by the many publicly traded entities that may have broker/dealer affiliates for limited corporate purposes. Subparagraph (c)(5) does not extend to a private company, which may avail itself of the *de minimis* exemption in paragraph (c)(4) discussed above.

6. Subparagraph (c)(6) exempts sales to and purchases by foreign investment companies. Specifically, the exemption applies to an investment company organized under the laws of a foreign jurisdiction that is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority, provided that no person owning 5 percent or more of the investment company is a restricted person. This exemption is similar to a existing provision in the Interpretation, but has been streamlined. NASD has eliminated requirements that a foreign investment company have 100 or more investors and limitations on the amount of the fund’s assets that can be invested in a particular security being offered. A foreign investment company that does not meet the conditions of subparagraph (c) may, however, be eligible to purchase new issues under the *de minimis* exemption.

NASD reminds firms that the foreign investment company exception is intended to extend benefits to foreign investment entities that are similar to U.S. mutual funds. In imposing a requirement that a foreign investment company be "authorized for sale to the public," NASD is attempting to equate to the way registered investment companies are offered in the United States. Foreign investment companies that are limited to high net worth individuals should not be considered "authorized for sale to the public," as a large segment of the foreign public would not be eligible to purchase them.

7. Subparagraph (c)(7) exempts sales to and purchases by an ERISA benefits plan that is qualified under Section 401(a) of the Internal Revenue Code (IRC), provided that such plan is not sponsored solely by a broker/dealer. Thus, a plan sponsored by a broad-based financial services company that includes a broker/dealer subsidiary would be eligible to purchase new issues. The ERISA plan exemption is similar to a provision in the current Interpretation.
8. Subparagraph (c)(8) exempts sales to and purchases by a state or municipal government plans that is subject to state and/or municipal regulation. This exemption reflects the fact that purchases of new issues by government and municipal plans, while not qualified under ERISA, do not raise concerns under the Rule.
9. Subparagraph (c)(8) exempts sales to and purchases by a tax-exempt charity organized under Section 501(c)(3) of the IRC. NASD believes that sales of new issues to these charities are consistent with the purposes of the Rule and foster a bona fide public distribution.
10. Subparagraph (c)(10) exempts sales to and purchases by church plans described in Section 414(e) of the IRC. Church plans, which are operated for the benefit of employees of a church or a convention or association of churches, are similar to other ERISA plans, but are not qualified under Section 401(a) of the IRC. NASD finds that the rationale for exempting ERISA plans qualified under Section 401(a) of the IRC applies equally to church plans as defined under Section 414(e) of the IRC.

D. Issuer-Directed Securities

Paragraph (d) addresses issuer-directed securities. Subparagraph (d)(1) exempts, for most purchasers, securities that are specifically directed by the issuer. The issuer-directed exemption for sales to and purchases by persons who are broker/dealer personnel, as defined in subparagraph (i)(10)(B), and finders and fiduciaries, as defined in subparagraph (i)(10)(C), applies only if such persons, or a member of their 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.⁹ Unlike the Interpretation, the Rule 2790 issuer-directed exemption does not require that issuer-directed securities be subject to a three-month lock-up. NASD also believes that the issuer-directed exemption should apply only when shares are in fact directed by an issuer. Thus, members should not seek to circumvent

prohibitions of the Rule by seeking to have issuers direct securities to restricted persons on their behalf. NASD also will continue its practice of holding a managing underwriter responsible for ensuring that all issuer-directed securities are distributed in accordance with the Rule.

Subparagraph (d)(2) creates an exemption for securities distributed as part of a program sponsored by the issuer, or an affiliate of the issuer, that meets four conditions: (1) the opportunity to purchase a new issue under the program is offered to at least 10,000 participants; (2) 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; (3) if not all participants receive shares under the program, the selection of the eligible participants is based on a random or other non-discretionary allocation method; and (4) the class of participants does not contain a disproportionate number of restricted persons.¹⁰ This exemption codifies the NASD staff position taken in several exemptive letters under the Interpretation.

Subparagraph (d)(3) exempts new issues directed to eligible purchasers as part of a conversion offering¹¹ conducted in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering. This exemption is similar to an exemption in the Interpretation.

E. Anti-Dilution Provisions

Paragraph (e) of the Rule contains “anti-dilution” provisions. This provision permits a restricted person that is an existing equity owner of an issuer to purchase shares of the issuer in a public offering in order to maintain its equity ownership position. A restricted person seeking an exemption under this provision must meet the following criteria: (1) the account has held an equity ownership interest in the issuer for a period of one year prior to the effective date of the offering; (2) the sale of the new issue to the account does 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 does not include any special terms; and (4) the new issue purchased pursuant to this exemption is not sold or transferred for three months following the effective date of the offering. Paragraph (e) replaces the substantially similar “Venture Capital Investors” exemption of the Interpretation.

F. Stand-By Purchasers

Paragraph (f) of the Rule contains an exemption for stand-by purchasers. Specifically, paragraph (f) provides that the prohibitions on the purchase and sale of new issues do not apply to purchases and sales made pursuant to a stand-by agreement that meets the following four 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 represents in writing that it is unable to find any other

purchasers for the securities; and (4) securities sold pursuant to the stand-by agreement are subject to a three-month lock-up period. Paragraph (f) is substantively similar to a provision in the Interpretation.

G. Under-Subscribed Offerings

Paragraph (g) permits an underwriter, pursuant to an underwriting agreement, to retain a portion of an offering of a new issue in its investment account if it is unable to sell that portion to the public. This is a new provision that became necessary as a result of the change in the Rule to apply to all new issues, not just those that were hot issues. Because the Rule applies to all new issues, even those for which they may not be sufficient demand, the Rule permits an underwriter to place unsold shares into its investment account. Members should be aware that this provision does not permit a member to place unsold shares into an account of another restricted person. Members are not permitted to place unsold shares into an account beneficially owned by restricted persons (other than an investment account of the member) because the net effect of such a provision would be akin to a hot issue standard (equating lack of demand with a flat or lower opening price in the secondary market), which the Rule seeks to abandon.

H. Exemptive Relief

Paragraph (h) provides the staff with the authority to grant an exemption for any or all of the provisions of the Rule if it determines that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest. The exemptive authority under Rule 2790 is similar to the exemptive authority in the Interpretation. Consistent with guidance from SEC staff, NASD intends to use its exemptive authority only in circumstances that are “truly unique.”¹²

I. Definitions of Key Terms

1. *Beneficial Interest*

Subparagraph (i)(1) defines the term “beneficial interest” as any economic interest, such as the right to share in gains and losses. Consistent with a previously articulated position under the Interpretation, the definition of “beneficial interest” excludes the receipt of a management or performance-based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity. The definition of “beneficial interest” differs from the definition in the Interpretation in that beneficial interest no longer includes solely a legal interest.

NASD offers the following guidance with respect to a performance-based fee that is deferred for tax or other purposes. The *initial* receipt of a performance-based fee would not constitute a beneficial interest in a collective account. However, the accumulation of these payments, if *subsequently* invested in the collective investment account (as a deferred fee arrangement or otherwise) would constitute a beneficial interest in the account.

2. *Collective Investment Account*

Subparagraph (i)(2) defines the term “collective investment account” as any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale of securities. As part of the reforms of Rule 2790, a collective investment account does not include a “family investment vehicle” or an “investment club.” Each of these terms is separately defined in the Rule.

3. *Immediate Family Member*

Several of the definitions of the term “restricted person” are extended to certain immediate family members. Subparagraph (i)(5) defines “immediate family member” as 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. Additionally, “immediate family member” includes any other individual to whom the person provides material support. This definition is substantively identical to the definition contained in the Interpretation.

4. *Material Support*

As noted above, several of the definitions of the term “restricted person” are extended to immediate family members that receive “material support” from a restricted person, or that provide “material support” to a restricted person. While the term “material support” was also used in the Interpretation, it was not a defined term. Rule 2790 defines the term as directly or indirectly providing more than 25 percent of a person’s income in the prior calendar year. In addition, members of the immediate family living in the same household are deemed to be providing each other with “material support.”

5. *New Issue*

Subparagraph (i)(9) defines the term “new issue” as any initial public offering of an equity security as defined in Section 3(a)(11) of the Securities Exchange Act of 1934, made pursuant to a registration statement or offering circular. Application of the Rule to all “new issues,” rather than just those that are “hot issues,” represents one of the most significant changes between Rule 2790 and the Interpretation. As the foregoing definition suggests, the Rule does not apply to secondary offerings. Similarly, the foregoing definition excludes offerings of debt securities.

Furthermore, in view of the broader definition encompassed by the term “new issue,” subparagraph (i)(9) expressly excludes other types of offerings. Subparagraph (i)(9)(A) excludes various private offerings. Subparagraph (i)(9)(B) excludes offerings of exempted securities. Subparagraph (i)(9)(C) excludes offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act. Subparagraph (i)(9)(D) excludes rights offerings, exchange offerings, or offerings made pursuant to a merger or acquisition. Subparagraph (i)(9)(E) excludes offerings of investment grade asset-backed securities. NASD believes that the exclusion for investment grade asset-backed securities is necessary because certain asset-backed securities may be considered equity rather than debt securities. Subparagraphs (i)(9)(F) and (G) exclude offerings of convertible and preferred securities, respectively. Subparagraph (i)(9)(H) excludes offerings of securities of an investment company registered under the Investment Company Act of 1940. Lastly, subparagraph (i)(9)(I) excludes offerings of securities (in ordinary form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States. This exemption in subparagraph (i)(9)(I) applies only to initial offerings of ADRs that are not part of a global initial public offering.¹³

In administering the Interpretation, NASD staff occasionally was asked if it was permissible to allow journal entries between the accounts of non-restricted persons and restricted persons when an offering was no longer a hot issue. Historically, NASD did not view the Interpretation as permitting journaling of hot issues from one account to another. In administering Rule 2790, NASD does not intend to require an outright purchase and sale of a new issue to transfer ownership interests (and risks) to restricted persons. NASD believes that it would be appropriate for firms to allow restricted persons to share in the subsequent gains and losses from new issues provided that restricted persons’ “purchase” of a new issue is not at the IPO price, but at the prevailing market price at the time their capital account reflects ownership of the security.

6. *Restricted Person*

The definition of “restricted person” covers five basic categories. Subparagraph (i)(10)(A) defines the term to include members or other broker/dealers. Subparagraph (i)(10)(B) defines the term to include broker/dealer personnel. Specifically, subparagraph (i)(10)(B)(i) extends the definition of restricted person to include any officer, director, general partner, associated person, or employee of a member or any other broker/dealer (other than a limited business broker/dealer).¹⁴ Subparagraph (i)(10)(B)(ii) provides that agents of a member or any other broker/dealer (other than a limited business broker/dealer) are restricted persons if they are engaged in the investment banking or securities business. Subparagraph (i)(10)(B)(iii) treats as a restricted person an immediate family member of a person specified in subparagraphs (B)(i) or (B)(ii) above, if that person: (a) materially supports or receives 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 issue.

Subparagraph (i)(10)(C)(ii) treats finders and fiduciaries as restricted persons. Specifically, a restricted person includes, 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. The Rule also treats as a restricted person an immediate family member of a finder or fiduciary if the finder or fiduciary materially supports, or receives support from, the immediate family member. The provisions addressing finders and fiduciaries are similar to provisions in the Interpretation, but narrower in that they are limited to finders and fiduciaries in the particular offering.

Subparagraph (i)(10)(D) treats portfolio managers as restricted persons. As noted above, one of the more significant changes under the new Rule is the elimination of the “conditionally restricted” status. Rule 2790 defines as a restricted person any person who has the authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account. Although such persons are deemed to be restricted persons under the Rule, this category is substantially narrower than a similar category in the Interpretation in that it is based upon a person’s activities rather than just his or her status as a “senior officer” or a person in a securities department. This definition applies to natural as well as non-natural persons. Similar to the other definitions of restricted person, an immediate family member of a portfolio manager as defined in subparagraph (i)(10)(D)(i) that materially supports, or receives material support from, the portfolio manager, also is a restricted person. One notable change between Rule 2790 and the Interpretation is that a person who has authority to buy or sell securities for an investment club or a family investment vehicle is no longer deemed to be a restricted person based solely upon that investment authority.

Subparagraph (i)(10)(E) addresses owners of broker/dealers. NASD believes that the prohibition on purchases of new issues by a broker/dealer could be circumvented if the owners of a broker/dealer were permitted to purchase the new issue. Consequently, NASD has drafted the definition of restricted person to include owners of broker/dealers. Subparagraph (i)(10)(E)(i) captures direct owners by treating as a restricted person any person listed, or required to be listed, on Schedule A of Form BD¹⁵ (other than with respect to a limited business broker/dealer), except persons identified by an ownership code of less than 10 percent. Subparagraph (i)(10)(E)(ii) captures indirect owners by treating as a restricted person any person listed, or required to be listed, on Schedule B of Form BD,¹⁶ 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 . In addition, as Schedules A and B are used in connection with an initial application to become a broker/dealer, subparagraph (i)(10)(E)(iii) includes in the definition of restricted person any person listed, or required to be listed, on Schedule C of Form BD that meets the criteria of subparagraphs (i)(10)(E)(i) and (ii) above.

In general, Schedules A and B do not require reporting of direct or indirect owners of “public reporting companies.” However, persons owning significant concentrations of such persons may implicate the concerns the Rule is designed to address. Accordingly, subparagraphs (i)(10)(E)(iv) and (v) sweep in owners, above specified thresholds, of a public reporting company (other than a public reporting company that is listed on a national securities exchange or traded on the NASDAQ National Market). Owners of public reporting companies listed on a national securities exchange or traded on the NASDAQ National Market are excluded for reasons similar to those underlying the publicly traded entity exemption. Lastly, subparagraph (i)(10)(E)(vi) treats as a restricted person a member of the immediate family of a person specified in subparagraphs (i)(10)(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.

Finally, as noted above, pursuant to paragraph (a)(1), a member or an associated person may not sell a new issue to any account in which a restricted person has a beneficial interest. This provision precludes, absent an exemption, sales of new issues to accounts in which an owner of a broker/dealer has a beneficial interest, including subsidiaries of the broker/dealer. NASD believes that applying the Rule to subsidiaries and other accounts is necessary to prevent a restricted person from evading the restriction by directing a subsidiary to purchase a new issue on its behalf. The application of this provision in combination with the publicly traded entity exemption would, nevertheless, permit a subsidiary to purchase new issues if the owner of the subsidiary is eligible to purchase new issues under the publicly traded entity exemption as discussed above. Further, the restriction would not apply to a subsidiary that independently qualifies for any other exemption under the Rule (e.g., if the subsidiary is a tax-exempt charity organized under Section 501(c)(3) of the IRC). In addition, a subsidiary that is beneficially owned in part by restricted persons is eligible to use the *de minimis* exemption.

Effective Date

In view of the number of significant changes in Rule 2790, and in response to comments raised during the rulemaking process, NASD has agreed to allow a three-month transition period in which members may comply with either Rule 2790 or the Interpretation. NASD believes that allowing members the option to continue to comply with the Interpretation for an additional three months will allow those firms sufficient time to develop the necessary procedures and obtain the necessary customer representations to comply with Rule 2790. Moreover, during this time, members and associated persons may choose to comply with either the Interpretation or Rule 2790 on an account-by-account basis. However, we note that once a member chooses to comply with Rule 2790 rather than the Interpretation, it must ensure that all representations relied upon are in conformity with the provisions of Rule 2790 (*i.e.*, certifications made under the Interpretation, including those on behalf of investment partnerships under paragraph (f) will no longer be valid as the definitions of restricted persons has changed.) Effective **March 23, 2004**, all members and associated persons must comply with Rule 2790.

Endnotes

- 1 SEC Order Approving Proposed Rule Change and Amendments Nos. 1 Through 4 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 5 Thereto by the NASD Relating to Restrictions on the Purchase and Sale of Initial Public Offerings of Equity Securities, 61 Fed. Reg. 62126 (October 31, 2003) ("Approval Order") (File No. SR-NASD-99-60). See also Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. to Interpret Two Provisions of New NASD Rule 2790 Relating to Initial Public Offerings, Release No. 34-48973 (December 22, 2003) (File No. SR-NASD-2003-190).
- 2 Compliance with Rule 2790 does not obviate the need for firms that agreed to the Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors to comply with its terms.
- 3 The term selling group is defined in NASD Rule 0210(p).
- 4 Certain hedge funds, or subsidiaries thereof, elect to become registered broker/dealers and share a back-office with another broker/dealer. These entities are called JBOs.
- 5 Paragraph (a)(4)(C) refers specifically to "investment partnership" because we understand this is the most common organizational form of JBO hedge funds. We believe, however, that the decision to organize as a limited liability company, or some other corporate form, should not undermine the relief granted to hedge funds organized as JBOs or with JBO subsidiaries.

-
- 6 None of the preconditions for sale require certification by an attorney or accountant. Certain provisions of the Interpretation (e.g., paragraphs (f) and (g)) require a written representation from an attorney or accountant, but NASD has not continued to make this a condition in Rule 2790.
 - 7 For purposes of this provision, "affiliate" has the same meaning as in NASD Rules 2710 and 2720.
 - 8 Under NASD rules, a member that seeks authority to engage in public offerings must make that part of its membership application. If an existing member that is not authorized to engage in public offerings seeks to do so in the future, such member must make application under NASD Rule 1017. Application of this provision in Rule 2790 will depend on whether a firm is authorized to engage in the public offering of new issues, not whether it actually conducts such offerings. Thus, information in Item 12 of Form BD will not be conclusive of whether a firm is authorized to engage in public offerings, because a member is not required to list on Item 12 activity if it is less than 1 percent of annual revenue. If a firm indicates on Item 12 of Form BD that it is engaged as an underwriter or selling group member, affiliates of such firms cannot purchase new issues.
 - 9 For purposes of this provision, a parent/subsidiary relationship is established if the parent has the right to vote 50 percent or more of a class of voting security of the subsidiary, or has the power to sell or direct 50 percent or more of a class of voting security of the subsidiary.
 - 10 This condition is designed to ensure that a program is not directed to a group composed to a significant extent of restricted persons.
 - 11 "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.
 - 12 Approval Order, 68 *Fed. Reg.* at 62143.
 - 13 The definition of "new issue" is not limited to domestic securities offerings. Thus, the prohibitions in paragraph (a) of the Rule apply members and their associated persons with respect to foreign offerings.
 - 14 A limited business broker/dealer is defined as a 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. This definition is very similar to the definition in the Interpretation, but focuses on whether a firm is authorized to engage in a particular activity rather than on whether it engages in such activity.
 - 15 Schedule A is used by an applicant to list direct owners and executive officers in connection with an initial application to become a broker/dealer.
 - 16 Schedule B is used by an applicant to list indirect owners in connection with an initial application to become a broker/dealer.

©2003. NASD. All rights reserved. *Notice to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

ATTACHMENT A

Additions are underlined; deletions are in brackets.

IM-2110-1. ["Free-Riding and Withholding"]

Deleted in its entirety and replaced with:

Reserved.

* * *

IM-2750. Transactions with Related Persons

A member who is acting, or plans to act, as sponsor of a unit investment trust will not violate Rule 2750 if it accumulates securities with respect to which the member has acted as a syndicate member, selling group member or reallowance dealer in an account of the member or related person of the member if, at the time of accumulation, the member in good faith intends to deposit the securities into the unit investment trust at the public offering price and intends to make a bona fide public offering of the participation units of that trust. Members engaged in such activity, however, will continue to be subject to Rule 2790. [IM-2110-1, "Free-Riding and Withholding."]

* * *

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 the selling group to another member of the selling group 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; or

(C) purchases by a broker/dealer (or owner of a broker/dealer), organized as an investment partnership, of a new issue at the public offering price, provided such purchases are credited to the capital accounts of its partners in accordance with paragraph (c)(4).

(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 accounts or 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 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 is funded by premiums from 1,000 or more policyholders, or, if a general account, the insurance company has 1,000 or more policyholders; and

(B) the insurance company does not limit the policyholders whose premiums are used to fund the account principally to restricted persons, or, if a general account, the insurance company does not limit its policyholders principally to restricted persons;

(4) An account if the beneficial interests of restricted persons do not exceed in the aggregate 10% of such account;

(5) A publicly traded entity (other than a broker/dealer or an affiliate of a broker/dealer where such broker/dealer is authorized to engage in the public offering of new issues either as a selling group member or underwriter) that:

(A) is listed on a national securities exchange;

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

(C) is a foreign issuer whose securities meet 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 to persons that are restricted under the rule; provided, however, that securities directed by an issuer may not be sold to or purchased by 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 security 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; or

(3) are directed to eligible purchasers who are otherwise restricted under the rule 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 of securities. A "collective investment account" does not include a "family investment vehicle" or an "investment club."

(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 legal entity 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;
(H) offerings of an investment company registered under the Investment Company Act of 1940; and
(I) offerings of securities (in ordinary share form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States.
- (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);

(ii) 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; or

(iii) An immediate family member of a person specified in subparagraph (B)(i) or (ii) if the person specified in subparagraph (B)(i) or (ii):

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.

(ii) An immediate family member of a person specified in subparagraph (D)(i) that materially supports, or receives material support from, such person.

(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.

* * *

3040. Private Securities Transactions of an Associated Person

(a) through (d) No Change.

(e) Definitions

For purposes of this Rule, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790 [IM-2110-1, Free-Riding and Withholding]), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

* * *

9600. PROCEDURES FOR EXEMPTIONS

9610. Application

(a) Where to File

A member seeking an exemption from Rule 1021, 1022, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3210, 3350, 8211, 8212, 8213, 11870, or 11900, [Interpretive Material 2110-1,] or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of the Association and provide a copy of the application to the Office of General Counsel of NASD Regulation.