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October 22, 2003

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

Re: **File No. SR-NASD-1999-60**
Restrictions on the Purchase and Sale of Initial Equity Public Offerings
Amendment No. 5

Dear Ms. England:

NASD is submitting this Amendment No. 5 in response to comments received by the SEC from publication in the Federal Register of Amendment Nos. 3 and 4¹ of the above-referenced rule filing.² Amendment No. 5 also responds to questions raised by SEC staff. Attached as Exhibit A is a redlined version of the proposed rule change that shows the amended language. Attached as Exhibit B is the proposed rule change with the amendments incorporated into the rule language.

I. Issues Raised in the Comment Letters

A. Portfolio Managers

The comment letters from Willkie, MFA and Sidley raised concerns with the proposal in Amendment No. 4 to treat Portfolio Managers as restricted persons subject to the 10% *de minimis* exemption. Willkie, MFA and Sidley believe that Portfolio Managers should not be treated as restricted persons with respect to the accounts they manage. NASD staff disagrees and believes that treating Portfolio Managers as restricted persons is the proper approach. Portfolio Managers are hired and entrusted by

¹ 67 Fed. Reg. 75889 (December 10, 2002).

² The SEC received four comment letters: Letter to Jonathan G. Katz ("Katz") from Willkie Farr & Gallagher (Willkie) dated December 13, 2002; Letter to Katz from Managed Funds Association ("MFA") dated December 31, 2002; Letter to Katz from Sidley Austin Brown & Wood ("Sidley") dated January 9, 2003; and Letter to Katz from Mayer Brown Rowe & Maw ("Mayer") dated January 13, 2003. In addition, prior to publication in the Federal Register, the SEC received two comment letters: Letter to Katz from Willkie dated September 24, 2002 ("Willkie II"); and Letter to Katz from MFA dated October 15, 2002 ("MFA II").

investors to direct investments on their behalf. Consequently, many Portfolio Managers are in a position to direct substantial business to members, and as such, may seek to use this influence to obtain access to IPOs. The existing Interpretation, recognizing this potential conflict, seeks to limit purchases of IPOs by these persons by treating such persons as “conditionally restricted.” Proposed Rule 2790, in turn, seeks to limit purchases by Portfolio Managers by treating them as restricted, subject to the 10% *de minimis* exemption.

NASD staff also disagrees with Willkie’s, MFA’s and Sidley’s argument that the effect of treating Portfolio Managers as restricted persons would be to put the manager of a Collective Investment Account “in direct competition with investors for ownership of interests in the Collective Investment Account since the manager will wish to retain the entire 10% for himself or herself.”³ Moreover, any suggestion that Portfolio Managers will expect that they should be entitled to the full 10% *de minimis* exemption, even though their access to IPOs is derived in part from the accounts they manage, highlights the underlying rationale for the restrictions. NASD staff believes that a change in policy that would give Portfolio Managers, including hedge fund managers, unrestricted access to new issues, even if limited to funds they manage, is inconsistent with the purposes of the proposed rule change.

NASD staff also does not believe that the proposed rule change is so restrictive on Portfolio Managers that it would cause Portfolio Managers to “cash out other investors in their funds and manage their own money separately in the future.”⁴ In general, NASD staff would expect that the fees a Portfolio Manager receives for managing money would far exceed the profits he or she would receive from greater individual participation in IPOs.

Willkie, MFA and Sidley also assert that investors in Collective Investment Accounts “almost universally require Portfolio Managers to make and maintain a considerable personal investment in the Collective Investment Account,”⁵ to help align their interests with those of the investors. NASD staff does not believe that the proposed rule change will prevent Portfolio Managers from investing alongside their investors. A Portfolio Manager could, for instance, invest considerably more than 10% in a Collective Investment Account and use carve-out procedures with respect to new issue investments. A restricted Portfolio Manager may maintain an interest in a Collective Investment Account above the 10% threshold provided that its participation in new issues (along with other restricted persons in aggregate) does not exceed 10% of the profits from such new issues. NASD staff does not believe that public investors will be harmed by receiving a disproportionate amount of profits from new issues than the

³ Willkie II Letter at 2. See also MFA Letter at 3; Sidley Letter at 4-5.

⁴ MFA Letter at 3.

⁵ Willkie II Letter at 3. See also MFA Letter at 3; Sidley Letter at 4.

Portfolio Manager. We note that the SEC has not received any comment letters from investors urging that their Portfolio Managers be entitled to a greater portion of profits from new issues.

Sidley states that many Portfolio Managers defer their management and performance fees for income tax purposes. In return, they enter into a deferred compensation arrangement (“Deferred Fee Arrangement”), which represents a general unsecured obligation of the hedge fund to pay such fees at a future date. The Deferred Fee Arrangement increases the Portfolio Manager’s interest in the Collective Investment Account. NASD staff agrees that initial receipt of the fee does not constitute a beneficial interest because 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.” However, NASD staff believes that the accumulation of these payments, if subsequently invested in the Collective Investment Account (as a Deferred Fee Arrangement or otherwise), will constitute a beneficial interest in the account. Money invested in a Collective Investment Account is part of a person’s beneficial interest in the account even if the source of the money is from a Deferred Fee Arrangement. NASD staff does not believe that a decision to defer recognition of earnings for income tax purposes should alter the analysis of whether a person has a beneficial interest in a Collective Investment Account.

Lastly, MFA believed that NASD should allow a Collective Investment Account to use carve-outs to separate the interests of restricted and non-restricted persons, or to reduce the interests of restricted person to below the appropriate thresholds, to allow the account to invest in new issues. NASD staff agrees and intends to offer firms detailed guidance concerning the use of carve-out accounts in a *Notice to Members* to be published after approval of the proposed rule change.

B. Joint Back Office Broker/Dealers

Willkie also suggests changing the definition of “joint back office broker/dealer” (“JBO”) because it believes that as proposed the definition requires an inquiry into subjective factors such as the motivating factors for an entity to become a JBO. SEC staff also raised some concerns with the asserting that a JBO is not required to be registered as a broker/dealer.

The special provisions for JBOs relate to an exemption granted by the staff responding to amendments to the Interpretation in 1998 which had the effect of precluding hedge funds registered as JBOs or with JBO dealer subsidiaries from purchasing hot issues even if investors in the funds were not restricted. The staff granted an exemption stating that the decision of a hedge fund or a subsidiary of a hedge fund to voluntarily register as a broker/dealer for the purpose of receiving more favorable margin treatment under Federal Reserve Regulation T should not

automatically preclude the hedge fund from purchasing hot issues. The staff concluded that sales of hot issues to a hedge fund should instead be based upon a determination of the beneficial owners of the fund, and not be a function of whether the fund has sought more favorable margin treatment. The proposed rule text sought to codify this exemption.

To address the SEC staff's and Willkie's comments, NASD staff has proposed an alternative manner of exempting purchases of new issues by JBOs. Specifically, NASD staff proposes in paragraph (a)(4) an exclusion for "purchases by a broker/dealer (or owner of a broker/dealer), organized as a 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)." The foregoing exclusion will allow investment partnerships (*e.g.*, hedge funds) that register as a broker/dealer or that have a broker/dealer subsidiary to purchase new issues on the same terms as other investment partnerships. This is consistent with the relief granted in the original exemptive letter and avoids an inquiry into the underlying reasons for registering as a broker/dealer or whether registration was in fact necessary. Hedge funds that register as a broker/dealer or that have a broker/dealer subsidiary may purchase new issues so long as the beneficial interests of restricted persons do not exceed in the aggregate 10% of the fund. As discussed in section II.A., below, accounts that have are beneficially owned by restricted persons in excess of the 10% threshold may use carve-out procedures to limit the interests of restricted persons to below 10%.

Sidley raises a number of arguments concerning JBOs culminating with the view that there is no need for a specific exemption. We believe that Sidney misconstrues the proposed rule change. Sidney is correct in that determining whether a person is a restricted person, one should "look through" to the persons with the actual economic interest in the gains and losses in the account. If one can "look through" an account until each of the natural person owners is reached and along the way encounters no beneficial owners that are restricted persons, then the account may purchase new issues. However, if the process of "looking through" reveals a restricted person identified in paragraph (i)(11) – either a natural person or an entity (such as a broker/dealer) – then the account may be restricted. The next step in the analysis is to determine whether the account is the type that qualifies for an exemption under, for example, paragraph (c). This is the reason that NASD provided an exemption for JBOs. Otherwise, the JBO would be restricted even if it were beneficially owned entirely by non-restricted persons.

Finally, NASD staff does not intend to treat associated persons of a "joint back office broker/dealer" differently than persons associated with other broker/dealers. The decision to exempt JBOs under the proposed rule change is because the staff believes that the act of registering a Collective Investment Account as a JBO should not taint the *investors* in the account, who might otherwise not be restricted persons. On the other hand, NASD staff does not believe that this consideration about the *investors* in a

Collective Investment Account should also exclude from the scope of the proposed rule change persons *associated* with the JBO. The fact that such persons also might be Portfolio Managers does not compel a different result. Under the proposed rule change, as with the current Interpretation, persons may be restricted for several reasons – such persons cannot purchase new issues unless they have an exemption for all of their restricted categories.

C. Affiliates of Broker/Dealers

As stated in Amendment No. 4, NASD revised the scope of the publicly traded entity exemption. Sidley's letter suggests some confusion concerning the interplay between the publicly traded entity exemption and the provisions restricting owners of broker/dealers.⁶ NASD staff is offering this clarification. Direct and indirect owners of broker/dealers are required to be listed on Schedules A and B of Form BD and are restricted under paragraph (i)(11)(E) of the proposed rule change. In the absence of an exemption, a publicly traded company listed on Schedule B of Form BD would be a restricted person. Moreover, all accounts in which such publicly traded company has a beneficial interest, such as subsidiaries (and affiliates of the broker/dealer), also would be restricted (unless the account itself is entitled to an exemption, such as the *de minimis* exemption). The publicly traded entity exemption provides relief for many such publicly traded companies and their non-broker/dealer affiliates and subsidiaries.

Consider the case of a publicly traded parent of a broker/dealer that engages in public offerings. The publicly traded parent would be restricted under paragraph (i)(11)(E) and would not qualify for the publicly traded entity exemption. All accounts in which the parent had a beneficial interest, including 10% or more owned subsidiaries, also would be restricted persons, even if the business of the subsidiary was wholly unrelated to the broker/dealer activities. Next consider a publicly traded parent of a broker/dealer that does not engage in public offerings. The publicly traded parent would be restricted under paragraph (i)(11)(E); however, the parent entity would qualify for an exemption under paragraph (c)(5). The broker/dealer subsidiary would continue to be a restricted person, but the parent and other non-restricted subsidiaries would be eligible to purchase new issues.

⁶ The publicly traded entity exemption applies to certain issuers "listed on a national securities exchange" or "traded on the Nasdaq National Market." Sidley seeks clarification of whether the Nasdaq National Market includes the Nasdaq SmallCap Market. NASD believes that it does not. The publicly traded entity exemption does not apply to issuers on the Nasdaq SmallCap Market. In addition, NASD will consider whether to amend the publicly traded entity exemption when and if Nasdaq becomes a national securities exchange.

D. Insurance Company General, Separate or Investment Accounts

Proposed paragraph (c)(3) provides an exemption for certain widely held insurance company general, separate and investment accounts. Mayer suggests certain technical changes to this provision are necessary to reflect the nature of insurance company investments and the relationship to policyholders. NASD staff believes that these changes help to better define the scope of the intended exemption and also address many of the concerns articulated by Sidley.⁷ Accordingly, the exemption has been amended as follows (new text is underlined; deleted text is in brackets):⁸

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

(A) the account [has investments from] 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 [beneficial interests in] the [account] 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.

Sidley suggests that NASD delete the requirement that an insurance company account be funded by premiums from 1000 or more policyholders, reasoning that an account of any size should not pose a problem under the Rule so long as the policyholders are not, principally, Restricted Persons. NASD staff intends to maintain the numerical threshold. NASD staff believes that this numerical threshold helps provide further assurance that the new issues purchased by the insurance company accounts are not targeted for Restricted Persons. Moreover, if a separate account has only a few policyholders as suggested in the hypothetical example in Sidley's letter, NASD staff believes it would be appropriate for the insurance company to ascertain whether each of the individual policyholders is a Restricted Person. Such account, of course, still may be available to purchase new issues under the provisions of paragraph (c)(4).

⁷ Sidley Letter at 17.

⁸ NASD believes that the provisions in paragraph (c)(3) apply to all types of insurance companies, not just life insurance companies. However, NASD declines to amend the exemption to apply "across all industries." Insurance company investment activity is subject to extensive state regulation and extending an exemption "across all industries" may create unintended loopholes. Moreover, Sidley has offered no justification for extending the exemption "across all industries."

E. Definition of New Issue

Sidley believes that the definition of new issue should provided an express exception for “any offering of securities for which, at the time of the offering, an organized trading market is not expected to develop or in which the initial public offering price is based primarily on exogenous or market factors (such as, a rating by a nationally recognized statistical rating organization or the market price for a related security).” Sidley notes that the latter exception would exclude initial public offerings in the U.S. of American Depositary Shares (“ADSs”)⁹ representing underlying ordinary shares that are already trading on a foreign securities exchange. In such cases, the initial public offering price in the U.S. will be constrained by the price of the underlying shares in the foreign market. On Sidley’s first suggestion for an exception for an offering for which there is not expected to be an organized trading market, NASD staff does not intend to draft a specific exception. NASD staff believes that offerings of this type may be appropriate candidates for a exemption pursuant to paragraph (h). NASD staff can use its experience with such offerings – to the extent that they exist – to determine whether a formal exclusion is appropriate and what the parameters of any such exclusion would be.

Sidley’s second suggestion for an exception for an offering that is priced with reference to exogenous or market factors appears to be both too general and too broad. However, in the case of an ADR, NASD agrees that application of the Rule is not necessary inasmuch as the price of the offering is constrained by the price of the shares in the underlying foreign market. Accordingly, NASD staff agrees that an exception for an offering of ADRs is appropriate. Specifically, NASD staff will add new subparagraph (i)(10)(I) to exclude “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.”

Sidley also believes that the phrase “initial public offering” should not be construed to include an offering of securities on a continuous basis (such as under a shelf registration pursuant to SEC Rule 415 under the Securities Act of 1933). NASD staff agrees that such an offering would not be part of an “initial public offering,” unless it was the first registered offering of the company’s stock.

II. Comments from SEC Staff

A. Preconditions for Sale

The SEC staff has asked NASD staff to provide additional information concerning how paragraph (b), Preconditions for Sale, applies in a fund of funds

⁹ Although Sidley uses the term ADS, the SEC more commonly uses the term American Depositary Receipt (“ADR”). See SEC Rel. No 33-6894, 34-29226, 56 Fed. Reg. 24420 (May 30, 1991); SEC Form F-6. Accordingly, we shall use the term ADR.

context. In short, the application of the Rule does not differ for sales to a fund of funds. Paragraph (b) requires a representation from “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.” For a fund of funds, a person authorized to represent the beneficial owners of the master fund (*i.e.*, the fund that purchases the new issues from the member directly) is required to represent that the fund is able to purchase new issues. In making any such representation, NASD staff expects that the person will ascertain the status of any investors in feeder funds (*i.e.*, funds that invest in the master fund). If the representative of the master fund is unable to ascertain the status of investors in feeder funds, then the master fund must deem such feeder funds to be restricted persons and ensure that the profits from new issues are not allocated to such funds, or consider whether any other exemption may apply to the feeder fund(s), such as the 10% *de minimis* exemption under paragraph (c)(4). NASD staff will address this issue in the *Notice to Members* announcing the rule change.

B. Definition of New Issue

- **Asset-Backed Securities**

The SEC staff has asked whether the exclusion from the definition of “new issue” for “offerings of investment grade asset-backed securities” in paragraph (i)(10)(E) is necessary in view of the fact that the definition of new issue in paragraph (i)(10) is limited solely to “equity securities.” NASD staff believes that the exclusion is necessary. While most asset-backed securities are debt securities, certain types may be deemed “equity securities.”¹⁰

- **Convertible Securities**

The SEC staff also has asked NASD staff to elaborate on the exclusion for “offerings of convertible securities.” Although convertible securities generally are viewed as “debt securities,” which are exempt from the proposed rule change, the definition of “equity security” in Section 3(a)(11) of the Exchange Act, which forms the basis for the Rule’s definition of “new issue,” includes “any security convertible, with or without consideration, into such a security.” In Amendment No. 2, NASD discussed the proposed exclusion for convertible securities, noting that NASD had used its exemptive authority under

¹⁰ For a discussion of the status of asset-backed securities as debt securities, see, e.g., Simplification of Registration Procedures for Primary Securities Offerings, SEC Final Rules, Exchange Act Rel. No. 31345 (Oct. 22, 1992); 57 Fed. Reg. 48970 (Oct. 29, 1992); Letter to Joan Conley, NASD Regulation, Inc. from Cadwalader, Wickersham & Taft, dated June 12, 1997 (submitted in response to NASD Notice to Members 97-30 (May 1997)). NASD staff further notes that the exclusion for asset-backed securities in paragraph (l)(1) of the current Interpretation was added to address the potential status of certain asset-backed securities as equity securities.

the current Interpretation to exempt convertible securities that were convertible into “actively traded securities.” NASD added that in view of the NASD’s proposal to exempt all secondary or follow-on offerings from the new rule, the “actively traded” limitation was no longer relevant.

- Junk Debt

The SEC staff also has asked NASD staff to comment further on the exclusion of non-investment grade debt (so-called “junk-debt”). NASD has stated that “[t]he price of non-investment grade debt is based primarily upon interest rates and the creditworthiness of the issuer rather than the demand factors that typically govern equity securities.”¹¹ While we recognize that under certain circumstances, the trading characteristics of junk-debt may more closely resemble the underlying issuer’s equity securities than debt securities, for purposes of Rule 2790, the point in time at which the pricing and trading characteristics of junk debt are relevant *is at the time of the offering*. In general, NASD staff continues to believe that at the time of an offering, junk-debt will continue to trade based primarily upon interest rates and the creditworthiness of the issuer.

C. Closed-End Investment Companies

The SEC staff also has asked NASD staff to elaborate on its basis for excluding offerings of securities of closed-end investment companies. Closed-end investment companies differ from open-end investment companies in that they do not continually offer their shares and do not have an obligation to redeem their shares. Typically, during the funding stage of a closed-end investment company, the fund company is seeking as large an infusion of capital as possible. Generally, fund companies will expand the size of an offering to meet demand, because, among other things, a larger fund will usually mean greater overall management fees (if based on assets under management) and lower overall operating costs for investors (as the fixed costs are spread over a greater pool of capital).¹² Once the offering is complete, the fund company will deploy the capital raised according to the fund’s stated investment objectives and policies. The offering price of a closed-end investment company is set prior to funding, thus, the offering price is to an extent arbitrary. It is usually set based upon external considerations, such as listing standards and comparability with other, previous closed-end fund offerings. Given that a closed-end fund’s assets at the time of

¹¹ File No. SR-NASD-1999-60, Exchange Act Rel. No. 42325 (Jan. 10, 2000); 65 Fed. Reg. 2656 at 2659 (Jan. 18, 2000).

¹² In some cases, a fund company may seek to limit the amount of capital raised, e.g., where a larger amount of capital may interfere with the objective of the fund.

a public offering is the capital raised, it has historically commenced trading at a price very close to the public offering price.

D. Investment Advisers

In an earlier comment letter, Katten Muchin Zavis¹³ sought clarification on whether an investment adviser organized as an entity would be a restricted person. The definition of restricted person in paragraph (i)(1)(D) includes “[a]ny 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.” The definition of “person” encompasses non-natural persons. Thus, an entity organized as an investment adviser that has authority to buy and sell securities for any of the enumerated entities would be a restricted person.

III. Miscellaneous

During the course of this rulemaking, SEC staff has asked NASD staff to comment on various issues. In light of the time duration of the proposed rule change, NASD staff is confirming its response to certain questions raised by SEC staff or commenters.

- A commenter has asked whether the procedures for annual account verification require an affirmative response from a customer. While NASD has previously stated that the initial verification of a person’s status under the proposed rule change must be a positive affirmation of non-restricted status, NASD staff intends to permit annual verification of a person’s status to be conducted through the use of negative consent. We note that the SEC’s new books and records rules allow a firm to furnish a customer with account information and ask that he or she verify that the information is correct. Thus, the use of negative consent is consistent with the means of verifying account information for suitability and other purposes. We believe similar disclosure, confirming that an person is not a restricted person, would be appropriate. NASD staff also will permit the use of electronic communications for eligible customers, but consistent with the SEC Rule 17a-3, a member cannot verify customer account information orally.
- In addition, NASD staff has determined that a firm that registers as a broker/dealer under Securities Exchange Act Section 15(b)(11) (Broker/Dealer Registration with Respect to Transactions in Security Futures) shall be treated as a broker/dealer under Rule 2790.

¹³ Letter to Jonathan G. Katz from Katten Muchin Zavis, dated January 28, 2000.

Accordingly, the firm and its associated persons shall be restricted persons under the Rule.

- One commenter, Fried Frank, supported the exemption for insurance company accounts with large numbers of policyholders, but believed that a general exemption also should apply to mutual banks. NASD notes that an exemption similar to the one for insurance company accounts is contained in paragraph (c)(2) for bank common trust funds. The NASD does not, however, believe that this commenter has articulated a sufficient rationale for an exemption for mutual banks.
- NASD staff also is confirming that a foreign investment company that fails to meet the criteria of paragraph (c)(6) may be eligible for an exemption under the provisions of paragraph (b)(4). Each of the exemptions is independent, thus a person or account that fails to meet one exemption may still meet the conditions of another exemption.
- One commenter, Testa, sought guidance on the meaning of paragraph (d)(2)(D), which requires that “the class of participants does not contain a disproportionate number of restricted persons as compared to the investing public.” This condition is designed to ensure that a program is not directed to a group of persons composed to a significant extent of restricted persons. If an issuer has any questions about whether a specific program would qualify for this condition, the issuer should contact the NASD’s Office of General Counsel for interpretive guidance.
- One commenter, Fried Frank, has previously asked whether a member may rely on representations about the status of an account made by a person who the member “reasonably believes” is authorized to represent the beneficial owners of the account. NASD staff declines to amend the rule to contain the text urged by the commenter. NASD believes that members should use an appropriate level of diligence to determine whether an individual is authorized to represent the beneficial owners of the accounts, and that it is unnecessary to amend the proposed rule change.
- In a previous submission, Cadwalader recommended that the definition of “family investment vehicle” be expanded to include long-term family employees. NASD staff does not believe that the commenter has presented sufficient reason to exclude such persons and has declined to make this change. Moreover, NASD staff believes that permitting non-family persons into the exemption for family investment vehicles could open the exemption to abuse.

- The Chicago Board Options Exchange has recommended that members of an exchange that lease out their seats and that are not engaged in a securities business should not be considered restricted persons. NASD staff agrees, and would not treat such persons as restricted persons under the proposed rule change.
- Several commenters have urged NASD to allow entities that would be subject to the proposed rule change a transition period before coming into full compliance with it. NASD staff believes that a transition period would be reasonable and proposes a three-month period during which members could comply with either the Interpretation or the new rule. This three-month period would begin upon NASD's publication of a *Notice to Members* announcing any Commission final action on the proposed rule change. NASD will publish this *Notice to Members* no later than 60 days following a Commission approval.

We hope the foregoing fully responds to the issues raised by commenters and the SEC staff's questions. If the staff has any additional questions, please contact me at (202) 728-8104.

Very truly yours,

Gary L. Goldsholle

Rule 2790. Restrictions on the Purchase and Sale of Initial Equity Public Offerings**(a) General Prohibitions**

(1) A member or a person associated with a member may not sell, or cause to be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted herein.

(2) A member or a person associated with a member may not purchase a new issue in any account in which such member or person associated with a member has a beneficial interest, except as otherwise permitted herein.

(3) A member may not continue to hold new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

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

(A) sales or purchases from one member of 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 [has investments from] 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 [beneficial interests in] the [account] 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 [or joint back office broker/dealer (“JBO”)]if the beneficial interests of restricted persons do not exceed in the aggregate 10% of such account[or JBO];

(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[1])(B) or (i)(10[1])(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) [“Joint Back Office Broker/Dealer” means any domestic or foreign private investment fund that has elected to register as a broker/dealer solely to take advantage of the margin treatment afforded under Section 220.7 of Regulation T of the Federal Reserve. The activities of a joint back office broker/dealer must not require that it register as a broker/dealer under Section 15(a) of the Act.]

([8]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.

([9]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.

([10]9) “New issue” means any initial public offering of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular. New issue shall not include:

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

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

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

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

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

(F) offerings of convertible securities;

(G) offerings of preferred securities; [and]

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

([11]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.

Rule 2790. Restrictions on the Purchase and Sale of Initial Equity Public Offerings**(a) General Prohibitions**

(1) A member or a person associated with a member may not sell, or cause to be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted herein.

(2) A member or a person associated with a member may not purchase a new issue in any account in which such member or person associated with a member has a beneficial interest, except as otherwise permitted herein.

(3) A member may not continue to hold new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

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

(A) sales or purchases from one member of 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;

(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.