

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
(202) 728-8062-Direct
(202) 728-8075-Fax

December 18, 2003

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

Re: **File No. SR-NASD-2003-190 – Interpretations in a Forthcoming Notice to Members Describing Rule 2790**

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

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

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

cc: Michael Gaw

Enclosures

File No. SR-NASD-2003-190
Consists of 14 Pages
December 18, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) portions of a Notice to Members discussing the application of NASD Rule 2790. NASD is not proposing any textual changes to the Rules of NASD.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on October 6, 1999, which authorized the filing of the rule change with the SEC. The Nasdaq Stock Market, Inc. has been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on October 7, 1999. No other action by NASD is necessary for the filing of the proposed rule change.

(b) Questions regarding this rule filing may be directed to Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8104.

¹ 15 U.S.C. 78s(b)(1).

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On October 24, 2003, the Commission approved new NASD Rule 2790 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings).² As stated in the Commission approval order, NASD will publish a Notice to Members discussing the application of Rule 2790. In consulting with the Commission staff regarding the Notice, the Commission staff determined that two provisions in the Notice constitute interpretations of Rule 2790 that, due to their nature, should be filed as a proposed rule change.

The first provision relates to paragraph (a)(4)(C) of Rule 2790, which provides an exclusion for “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).” This exclusion is intended to allow a hedge fund that registers as a broker/dealer or that has a broker/dealer subsidiary³ to purchase new issues on the same terms as other investment partnerships. For instance, pursuant to paragraph (a)(4)(C), a JBO hedge fund may purchase new issues so long as the beneficial interests of restricted persons do not exceed in the

² See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126 (October 31, 2003) (order approving File No. SR-NASD-99-60).

³ 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 joint back office broker/dealers (“JBOs”).

aggregate 10% of the fund. NASD recognizes that there are a number of legal structures that a JBO hedge fund can take. Accordingly, the Notice will state:

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.

The second provision relates to the preconditions for sale in a fund-of-funds context.

Paragraph (b) of Rule 2790 provides, in relevant part, 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.

In a fund-of-funds context, 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”). However, in making such a representation, a representative of the master fund would need to ascertain the status of investors of any feeder funds that invest in the master fund. In ascertaining the status of investors of any feeder funds, NASD will allow the representative of the master fund to rely on information from any feeder fund. To address the practicalities of the certification process, the Notice will state:

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.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁴ which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that Rule 2790, as described herein, protects investors and the public interest by: ensuring that members make a bona fide public offering of securities at the public offering price; ensuring that members do not withhold securities in a public offering for their own benefit or use such securities to reward certain persons who are in a position to direct future business to the member; and ensuring that industry "insiders," including members and their associated persons, do not take advantage of their "insider" position in the industry to purchase "new issues" for their own benefit at the expense of public customers.

⁴ 15 U.S.C. 78o-3(b)(6).

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act⁵ and Rule 19b-4(f)(6) thereunder,⁶ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days (or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest) after the date of this filing. In accordance with Rule 19b-4(f)(6)(iii),⁷ NASD submitted written notice of its intent to file the proposed rule change (along with a brief

⁵ 15 U.S.C. 78s(b)(3)(A).

⁶ 17 CFR 240.19b-4(f)(6).

⁷ 17 CFR 240.19b-4(f)(6)(iii).

description and draft text of the proposed rule change) at least five business days prior to the date of this rule filing. In addition, NASD requests that the Commission waive the 30-day operative delay set forth in Rule 19b-4(f)(6)(iii).⁸

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

Date: December 18, 2003

⁸ Id.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2003-190)

December , 2003

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Rule 2790

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. NASD has designated the proposed rule change as constituting a “non-controversial” rule change pursuant to Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION’S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is filing with the Commission portions of a Notice to Members discussing the application of NASD Rule 2790. NASD is not proposing any textual changes to the Rules of NASD.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

On October 24, 2003, the Commission approved new NASD Rule 2790 (Restrictions on the Purchase and Sale of Initial Equity Public Offerings).⁴ As stated in the Commission approval order, NASD will publish a Notice to Members discussing the application of Rule 2790. In consulting with the Commission staff regarding the Notice, the Commission staff determined that two provisions in the Notice constitute interpretations of Rule 2790 that, due to their nature, should be filed as a proposed rule change.

The first provision relates to paragraph (a)(4)(C) of Rule 2790, which provides an exclusion for "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

⁴ See Securities Exchange Act Release No. 48701 (October 24, 2003), 68 FR 62126 (October 31, 2003) (order approving File No. SR-NASD-99-60).

(c)(4).” This exclusion is intended to allow a hedge fund that registers as a broker/dealer or that has a broker/dealer subsidiary⁵ to purchase new issues on the same terms as other investment partnerships. For instance, pursuant to paragraph (a)(4)(C), a JBO hedge fund may purchase new issues so long as the beneficial interests of restricted persons do not exceed in the aggregate 10% of the fund. NASD recognizes that there are a number of legal structures that a JBO hedge fund can take. Accordingly, the Notice will state:

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.

The second provision relates to the preconditions for sale in a fund-of-funds context. Paragraph (b) of Rule 2790 provides, in relevant part, 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.

In a fund-of-funds context, 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”). However, in making such a

⁵ 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 joint back office broker/dealers (“JBOs”).

representation, a representative of the master fund would need to ascertain the status of investors of any feeder funds that invest in the master fund. In ascertaining the status of investors of any feeder funds, NASD will allow the representative of the master fund to rely on information from any feeder fund. To address the practicalities of the certification process, the Notice will state:

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.

(2) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁶ which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that Rule 2790, as described herein, protects investors and the public interest by: ensuring that members make a bona fide public offering of securities at the public offering price; ensuring that members do not withhold securities in a public offering for their own benefit or use such securities to reward certain persons who are in a position to direct future business to the member; and ensuring that industry "insiders," including members and their associated persons, do not take advantage of their "insider"

⁶ 15 U.S.C. 78o-3(b)(6).

position in the industry to purchase “new issues” for their own benefit at the expense of public customers.

(B) Self-Regulatory Organization’s Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

The proposed rule change has been filed by NASD as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act⁷ and Rule 19b-4(f)(6) thereunder.⁸ Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days after the date of this filing; and NASD provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date,⁹ the proposed rule change

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ 17 CFR 240.19b-4(f)(6).

⁹ Rule 19b-4(f)(6)(iii) under the Act requires the self-regulatory organization to provide the Commission written notice of its intent to file the proposed rule change at least five business days before doing so (or such shorter time as designated by the Commission). The Commission finds that NASD satisfied the five-day pre-filing requirement by filing a written notice of its intent to file the proposed rule change (along with a brief description and draft text of the proposed rule change) at least five business days prior to the date of filing.

has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6) thereunder.¹¹

NASD has requested that the Commission waive the 30-day pre-operative waiting period, which would make the proposed rule change operative immediately. The Commission finds that it is consistent with the protection of investors and the public interest to waive the 30-day pre-operative period in this case because the proposed rule change provides additional guidance to investors regarding the application of Rule 2790. For these reasons, the Commission waives the 30-day pre-operative period and designates that the proposal become operative immediately.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change [as amended] is consistent with the act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

File No. SR-NASD-2003-190. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).