

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

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Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48701; File No. SR-NASD-99-60]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 Through 4 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 5 Thereto by the National Association of Securities Dealers, Inc. Relating to Restrictions on the Purchases and Sales of Initial Public Offerings of Equity Securities

October 24, 2003.

I. Introduction

On October 15, 1999, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change that would govern purchases and sales of "hot equity" offerings. On December 21, 1999, the NASD submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on January 18, 2000.⁴ On October 11, 2000, the NASD submitted Amendment No. 2 to the proposal⁵ which, among other things, changed the subject of the proposed rule from "hot issues" to "new issues." Amendment No. 2 was published for comment in the **Federal Register** on December 6, 2000.⁶ The NASD submitted Amendment No. 3 to the proposal on March 20, 2001,⁷ and

Amendment No. 4 to the proposal on June 27, 2002.⁸ The Commission published the proposal as revised by Amendment Nos. 3 and 4 in the **Federal Register** on December 10, 2002.⁹ On October 23, 2003, the NASD submitted Amendment No. 5 to the proposal.¹⁰ This notice and order approves the proposed rule change and Amendment Nos. 1 to 4 thereto, solicits comment on Amendment No. 5, and approves Amendment No. 5 on an accelerated basis.

II. Executive Summary

Currently, NASD Interpretative Material ("IM") 2110-1, commonly known as the "Free-Riding and Withholding Interpretation" ("Interpretation"), governs the manner in which NASD members may distribute "hot issues." The NASD has proposed to restructure and make substantive amendments to the Interpretation; the result would be codified as new NASD Rule 2790. The NASD has stated that the new rule, like the Interpretation it would replace, 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 NASD believes that the proposed rule is better designed to further the purposes of the Interpretation, while at the same time being easier to understand.

Under new NASD Rule 2790, an NASD member generally would be prohibited from selling a "new issue" to any account in which a "restricted person" had a beneficial interest. As discussed further below, the term "restricted person" would include most broker-dealers, most owners and affiliates of a broker-dealer, and certain other classes of person. The proposed rule would require a member, before

selling a new issue to any account, to meet certain "preconditions for sale." These preconditions generally would require the member to obtain a representation from the beneficial owner of the account that the account is eligible to purchase new issues in compliance with the rule. The rule would provide several general exemptions, the basic rationale of which is that sales to and purchases by entities that have numerous beneficial owners—and, therefore, are likely to have only a small percentage of restricted persons owners—are not the types of transactions the rule should proscribe. The details of proposed NASD Rule 2790 are discussed in Section IV below.

III. Procedural History and Comments Received

The proposal, as revised by Amendment No. 1, was published for comment in the **Federal Register** on January 18, 2000.¹¹ The Commission received 24 comments on the original notice.¹² In response to these comments,

¹¹ See *supra* note 4.

¹² See Letter from Willkie Farr & Gallagher to Jonathan G. Katz, SEC, dated January 28, 2000 ("Willkie"); Letter from Faith Colish to Jonathan G. Katz, SEC, dated January 31, 2000 ("Colish"); Letter from Katten Muchin Zavis to Jonathan G. Katz, SEC, dated January 28, 2000 ("Katten"); Letter from Sandra K. Smith to Jonathan G. Katz, SEC, dated February 1, 2000 ("Smith"); Letter from Driehaus Capital Management, Inc. to Jonathan G. Katz, SEC, dated February 4, 2000 ("Driehaus"); Letter from Cadwalader, Wickersham & Taft to Jonathan G. Katz, SEC, dated February 4, 2000 ("Cadwalader"); Letter from Fu Associates, Ltd. to Jonathan G. Katz, SEC, dated February 7, 2000 ("Fu"); Letter from Schulte Roth & Zabel LLP to Jonathan G. Katz, SEC, dated February 7, 2000 ("Schulte"); Letter from Rosenman & Colin LLP to Jonathan G. Katz, SEC, dated February 7, 2000 ("Rosenman"); Letter from Ropes & Gray to Jonathan G. Katz, SEC, dated February 8, 2000 ("Ropes"); Letter from The Washington Group to Jonathan G. Katz, SEC, dated February 8, 2000 ("Washington"); Letter from Testa, Hurwitz & Thibault, LLP to Jonathan G. Katz, SEC, dated February 8, 2000 ("Testa"); Letter from Northern Trust Global Advisors, Inc. to Jonathan G. Katz, SEC, dated February 13, 2000 ("Northern Trust"); Letter from Chicago Board Options Exchange to Jonathan G. Katz, SEC, dated February 14, 2000 ("CBOE"); Letter from Sullivan & Cromwell to Jonathan G. Katz, SEC, dated February 15, 2000 ("Sullivan"); Letter from Charles Schwab to Jonathan G. Katz, SEC, dated February 15, 2000 ("Schwab"); Letter from Sidley & Austin to Jonathan G. Katz, SEC, dated February 16, 2000 ("Sidley"); Letter from North American Securities Administrators Association, Inc. to Jonathan G. Katz, SEC, dated February 18, 2000 ("NASAA"); Letter from Securities Industry Association to Jonathan G. Katz, SEC, dated February 18, 2000 ("SIA"); Letter from Mayor, Day, Caldwell & Keeton, L.L.P. to SEC, dated March 8, 2000 ("Mayor Day"); Letter from Morgan Stanley Dean Witter to Jonathan G. Katz, SEC, dated March 17, 2000 ("MSDW"); Letter from Covington & Burling to Jonathan G. Katz, SEC, dated April 14, 2000 ("Covington"); Letter from Orrick, Herrington & Sutcliffe LLP to Jonathan G. Katz, SEC, dated May 2, 2000 ("Orrick"); Letter from Fried, Frank, Harris, Shriver & Jacobson to Jonathan G. Katz, SEC, dated May 9, 2000 ("Fried").

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Gary L. Goldsholle, NASD, to Katherine A. England, Division of Market Regulation, SEC, dated December 20, 1999 ("Amendment No. 1").

⁴ Securities Exchange Act Release No. 42325 (January 10, 2000), 65 FR 2656.

⁵ See Letter from Alden S. Adkins, NASD, to Katherine A. England, Division of Market Regulation, SEC, dated October 10, 2000 ("Amendment No. 2").

⁶ Securities Exchange Act Release No. 43627 (November 28, 2000), 65 FR 76316.

⁷ See Letter from Patrice M. Gliniecki, NASD, to Katherine A. England, Division of Market

Regulation, SEC, dated March 20, 2001 ("Amendment No. 3").

⁸ See Letter from Gary L. Goldsholle, NASD, to Katherine A. England, Division of Market Regulation, SEC, dated June 27, 2002 ("Amendment No. 4").

⁹ See Securities Exchange Act Release No. 46942 (December 4, 2002), 67 FR 75889.

¹⁰ See Letter from Gary L. Goldsholle, NASD, to Katherine A. England, Division of Market Regulation, SEC, dated October 22, 2003 ("Amendment No. 5").