

The NASD agreed, and this revision is reflected in paragraph (i)(10)(D) of the proposed rule.

Paragraph (i)(10)(E) would exclude offerings of investment-grade asset-backed securities from the definition of "new issue." This provision would preserve an exemption in the Interpretation for financing-instrument-backed securities that are rated investment-grade.⁶⁵ In Amendment No. 5, the NASD explained that a separate exclusion for asset-backed securities was necessary even though the proposed rule already contains an exclusion for debt securities; certain types of asset-based securities may be considered equity rather than debt and therefore might not be covered by the proposed rule's implicit exemption for debt securities.

Paragraph (i)(10)(F) would exclude offerings of convertible securities. Under the literal terms of the Interpretation, debt securities that are convertible into common or preferred stock may be hot issues.⁶⁶ The NASD staff has exercised its exemptive authority⁶⁷ to exclude many convertible securities from the Interpretation. The NASD has now proposed to codify this exemption in the proposed rule.⁶⁸

Paragraph (i)(10)(G) would exclude offerings of preferred securities. The NASD has stated that, in connection with the 1998 amendments, it considered—but deferred—an exemption for preferred securities.⁶⁹ However, the NASD is now proposing to exempt preferred securities because it believes, on balance, that these securities exhibit pricing and trading behavior more closely resembling that of debt rather than equity securities and, thus, should not be considered "new issues."

Paragraph (i)(10)(H) would exclude offerings of securities of an investment company registered under the Investment Company Act of 1940.⁷⁰ The NASD initially proposed to exclude only the securities of closed-end investment companies, as defined in Section 5(a)(2) of the Investment Company Act.⁷¹ The NASD believes that these securities typically commence

trading at the public offering price with little potential for trading at a premium because the fund's assets at the time of the offering are the capital it has previously raised. The NASD concluded, therefore, that deeming the securities of closed-end funds to be new issues would do little to further the purposes of the proposed rule. One commenter agreed with the NASD's decision to exempt offerings of securities of closed-end investment companies but questioned why the exemption did not extend to any type of investment company registered under the Investment Company Act of 1940.⁷² The NASD agreed and revised paragraph (i)(10)(H) accordingly.

Paragraph (i)(10)(I) would exclude an offering of securities (in ordinary share form or American Depositary Receipts ("ADRs") registered on Form F-6) that have a pre-existing market outside the United States. One commenter suggested that the proposed rule should exclude an offering of securities of 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)." ⁷³ The NASD believes that this suggestion is too broad.

However, in the case of an ADR, the NASD agrees that application of the proposed rule is not necessary because the price of the offering will be constrained by the price of the shares in the underlying foreign market. Therefore, in Amendment No. 5, the NASD added new paragraph (i)(10)(I) to the proposed rule. The NASD notes that this exemption would apply only to initial offerings of ADRs that are not part of a global initial public offering.

d. *Miscellaneous Issues Regarding Scope of Term "New Issue"*. One commenter ⁷⁴ recommended that the definition of "new issue" expressly exempt offerings of securities made pursuant to Regulation S ⁷⁵ under the Securities Act of 1933. The NASD does not believe that this commenter sufficiently demonstrated that this exemption would be consistent with the purposes of the proposed rule and has determined not to adopt it.

In Amendment No. 2, the definition of "new issue" proposed by the NASD included "other securities distributions of any kind whatsoever, including securities that are specifically directed by the issuer on a non-underwritten basis." Several commenters noted that

this language was surplusage and potentially misleading.⁷⁶ The NASD agreed and deleted this language from the definition.

One commenter recommended that the definition of "new issue" exclude any offering of securities for which, at the time of the offering, an organized trading market is not expected to develop.⁷⁷ In Amendment No. 5, the NASD responded that it was not necessary to draft a general exemption in the rule, and that offerings of this type might be candidates for specific exemptions granted by the NASD staff pursuant to their authority under paragraph (h) of the proposed rule.⁷⁸

The same commenter ⁷⁹ argued that the term "initial public offering" used in the definition of "new issue" should be construed to exclude any offering of securities made on a continuous basis (such as under a "shelf" registration statement pursuant to Rule 415 of Regulation C under the Securities Act of 1933 ⁸⁰). In Amendment No. 5, the NASD agreed that such an offering would not be part of an "initial public offering" unless it were the first registered offering of the company's stock.

2. Restricted Persons

Paragraph (a)(1) of proposed NASD Rule 2790 would stipulate that a member or associated person thereof may not sell a new issue to any account in which a restricted person has a beneficial interest, unless such sale qualifies for an enumerated exemption. The scope of the term "restricted person" is discussed below.

a. *Broker-Dealers and Their Personnel*. Paragraph (i)(11)(A) of the proposed rule would define "restricted person" to include NASD members and other broker-dealers. Paragraph (i)(11)(B)(i) would extend the definition of "restricted person" to include any officer, director, general partner, associated person, or employee of a member or any other broker-dealer. Paragraph (i)(10)(B)(ii) would provide that agents of a broker-dealer are not considered restricted persons unless they are engaged in the investment banking or securities business.

⁷⁶ See MSDW 2 (arguing that non-underwritten securities should not be covered by the proposed rule since, by definition, NASD members would not be involved in the offering); Sullivan 2 (noting that this language would have the effect of including secondary offerings in the rule, even though the NASD's stated intent was to exempt secondary offerings); Willkie 2.

⁷⁷ See Sidley 2.

⁷⁸ But see *infra* note and accompanying text.

⁷⁹ See *id.*

⁸⁰ 17 CFR 230.415.

⁶⁵ See NASD IM-2110-1(l)(1).

⁶⁶ See *id.*

⁶⁷ See NASD IM-2110-1(a)(5).

⁶⁸ One commenter recommended that the proposed rule not apply to debt securities that are convertible into "actively traded" equity securities. See MSDW. The NASD believes that, in view of the decision to exclude all secondary offerings, all convertible securities, not just those that are convertible into "actively traded" securities, should be excluded.

⁶⁹ See 1998 amendments, 63 FR at 28537.

⁷⁰ 15 U.S.C. 80a-1 *et seq.*

⁷¹ 15 U.S.C. 80a-5(a)(2).

⁷² See Cadwalader 2.

⁷³ Sidley 2.

⁷⁴ See Sullivan 2.

⁷⁵ 17 CFR 230.901 *et seq.*