

However, the NASD does not believe that all senior officers and employees of a securities department of one of these entities need be restricted. Therefore, the NASD devised a function-oriented approach that, in its original form, would have treated as a restricted person “[a]ny employee or other person who supervises, or whose activities directly or indirectly involve or are related to, the buying or selling of securities” for one of the listed entities.

In response to the original proposal, three commenters stated that they supported the functional approach but believed that the proposed rule language was too broad and could reach persons whose functions were purely ministerial.<sup>90</sup> These commenters suggested that only to persons who have authority to make investment decisions should be restricted. The NASD agreed and revised the proposed rule text accordingly in Amendment No. 2.<sup>91</sup> Accordingly, paragraph (i)(11)(D)(i) of the proposed rule would define a portfolio manager as 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.

One commenter sought clarification on whether an investment advisor organized as a non-natural person would be deemed a restricted person.<sup>92</sup> This commenter stated that the proposed rule treats certain employees of an investment advisor as restricted persons but is not clear whether the investment advisor itself is a restricted person. In Amendment No. 5, the NASD observed that the definition of “portfolio manager” in paragraph (i)(1)(D)(i) encompasses non-natural persons. Thus, an entity organized as an investment advisor that has authority to buy and sell securities for any of the entities enumerated above would be a portfolio manager for the purposes of the proposed rule and, as such, a restricted person.

Another commenter recommended excluding from the definition of “portfolio manager” a hedge fund manager of a fund with less than \$200 million in assets.<sup>93</sup> The NASD believes that the reasons for treating hedge fund

managers as restricted persons are not limited by the size of the assets under management, especially with amounts as significant as those proposed by the commenter. Therefore, the NASD declined to accept this recommendation.

Finally, one commenter requested that the proposed rule include an exemption for persons who, on a volunteer basis, make investment decisions on behalf of a tax-exempt charitable organization.<sup>94</sup> The NASD believes that the purposes of the rule may be implicated by persons who manage such organizations. The NASD, therefore, declined to accept this suggestion.

e. *Owners of Broker-Dealers.* In the view of the NASD, a prohibition on new issue purchases by a broker-dealer could be circumvented if the broker-dealer’s owners were permitted to purchase the new issue. Therefore, the NASD has proposed to deem owners of a broker-dealer as restricted persons as well.

Under the original proposal, the term “restricted person” included any natural person (or member of the person’s immediate family) who owned 10% or more, or contributed 10% or more of the capital, of a broker-dealer. Many of the commenters believed that this restriction was too broad and would be overly burdensome.<sup>95</sup> In Amendment No. 2, the NASD adopted a new approach that bases ownership of a broker-dealer for purposes of the rule on whether the broker-dealer must report the ownership interest on Form BD. The NASD favors this approach because it would not have to create new concepts of ownership for purposes of the rule: The Form BD reporting requirements are well understood by NASD members, who already maintain such information.

One commenter criticized this approach on the grounds that persons who might in fact have very little voting power or beneficial interest in the broker-dealer would be treated as restricted persons, which would not further the purposes of the rule.<sup>96</sup> A person must be reported on Form BD if it holds a designated percentage of “a class of voting security” of the reporting broker-dealer. The commenter noted that, depending on the broker-dealer’s capital structure, a particular class of voting security might represent only a small portion of the firm’s capital. Nevertheless, a person owning 10% or more of that class would be a restricted person under the proposed rule. The commenter recommended that the

ownership interests reported in Schedules A and B of Form BD should be multiplied so that only the actual economic interest would be used to determine whether the person is restricted.

The NASD has determined not to accept the commenter’s suggestion. In Amendment No. 4, the NASD stated that it seeks to aid members’ compliance efforts by eliminating the need to perform calculations in determining ownership interests in a broker-dealer. In its experience, such calculations are often difficult and frequently raise interpretive issues with various ownership structures. The NASD deliberately sought to eliminate that level of complexity by referencing persons listed on Schedules A and B, noting that there are no special codes or identifiers on Schedule B to identify persons with only a small economic interest.

The same commenter also suggested an exemption from the proposed definition of “restricted person” for an entity disclosed on Schedule A or B of Form BD that is listed on a foreign exchange. Pursuant to Form BD, a broker-dealer must report entities that have interests at every level of its ownership structure that exceed designated percentages. However, once a public reporting company is reached, no ownership information further up the chain need be given.<sup>97</sup> Only those public reporting companies that are subject to Sections 12 or 15(d) of the Act<sup>98</sup> may avail themselves of this exclusion. The NASD has proposed to follow the Form BD in this regard; thus, a foreign entity with an ownership interest in a broker-dealer would not be a restricted person if that foreign entity were subject to Sections 12 or 15(d) of the Act.<sup>99</sup>

The general restriction on owners of a broker-dealer would not extend to owners of a limited business broker-dealer. One commenter recommended that, because *associated persons* of a limited business broker-dealer were not restricted, the *owners* of a limited business broker-dealer also should not be restricted.<sup>100</sup> The NASD agreed and revised the proposed rule text accordingly.

f. *Affiliates of Broker-Dealers.* The proposed rule would treat as restricted persons not only owners of a broker-dealer, but also affiliates of the broker-

<sup>90</sup> See Ropes; Schwab; Testa.

<sup>91</sup> However, one commenter suggested that a portfolio manager should be restricted based on whether this person “exercises” authority to make investment decisions, not whether such person is “authorized” to make investment decisions. See Fried. The NASD believes that the alternative standard proposed by this commenter is too narrow and has not made this change.

<sup>92</sup> See Katten.

<sup>93</sup> See Washington.

<sup>94</sup> See Schwab.

<sup>95</sup> See Colish; Orrick; SIA; Sidley; Willkie.

<sup>96</sup> See Fried 2.

<sup>97</sup> See Form BD, Schedule B, Instruction 3.

<sup>98</sup> 15 U.S.C. 78l and 78o.

<sup>99</sup> A foreign entity also might be eligible to purchase new issues pursuant to the proposed rule’s exemption for publicly traded entities. See *infra* notes—and accompanying text.

<sup>100</sup> See Willkie 2.