

accommodation to a non-restricted person customer of the broker-dealer.

#### 4. General Exemptions

Paragraph (c) states that the proposed rule's general prohibitions would not apply to sales to or purchases from several classes of persons, whether directly or through accounts in which such persons have a beneficial interest.<sup>118</sup> These classes of person are described below.

a. *Investment Companies.* Paragraph (c)(1) of the proposed rule states that sales of new issues to, or purchases by, an investment company registered under the Investment Company Act of 1940<sup>119</sup> would not be subject to the rule. This provision would preserve an existing exemption in the Interpretation.<sup>120</sup>

b. *Common Trust Funds and Insurance Companies.* Paragraphs (c)(2) and (c)(3) would provide exemptions for sales of new issues to, or purchases by, certain trust funds and insurance company accounts, respectively. To qualify for these exemptions, a trust fund would have to have investments from 1,000 or more accounts, and an insurance account would have to be funded by premiums from 1,000 or more policyholders (or, if a general account, the insurance company would have to have 1,000 or more policyholders).<sup>121</sup> In addition, the fund or insurance account may not limit its participation principally to restricted persons.<sup>122</sup>

Under the original proposal, the exemption for general, separate, or investment accounts of insurance companies would apply only if the account "has investments from" 1,000 or more policyholders. One commenter recommended that the proposed rule use the term "funded by" policyholders instead of "has investments from" policyholders; an insurance company general account generally is owned by the insurance company itself, so the policyholders do not technically invest in or fund the account.<sup>123</sup> The NASD agreed and in Amendment No. 5 revised the proposed rule text accordingly.

One commenter suggested that the NASD delete the proposed requirement that an insurance company account be funded by premiums from 1,000 or more policyholders, reasoning that an account of any size would not pose a problem under the new rule so long as the policyholders were not, principally, restricted persons.<sup>124</sup> In Amendment No. 5, the NASD stated its intent to retain this numerical threshold because it provides further assurance that new issues purchased by an insurance company account are not targeted for restricted persons. The NASD added that, if an insurance company separate account has only a few policyholders (as suggested in the commenter's hypothetical), it would be appropriate for the insurance company to ascertain whether each of the individual policyholders was a restricted person.

The same commenter also recommended that the new rule specifically confirm that the insurance company account exemption is not limited to life insurance companies, but applies "across all industries."<sup>125</sup> In Amendment No. 5, the NASD stated that paragraph (c)(3) of the proposed rule would apply to all types of insurance companies and that amending the exemption to apply "across all industries" could create unintended loopholes.

One commenter recommended that the proposed rule include a general exemption for mutual banks, in the same way that it would exempt mutual insurance companies.<sup>126</sup> In Amendment No. 5, the NASD noted that an exemption similar to the one for insurance company accounts is contained in paragraph (c)(2) of the proposed rule for bank common trust funds. The NASD does not, however, believe that the commenter has articulated a sufficient rationale for an exemption for mutual banks.

c. *Publicly Traded Entities.* Paragraph (c)(5) of the proposed rule would provide a general exemption for publicly traded entities (except broker-dealers and certain affiliates thereof) that are listed on a national securities exchange, are traded on the Nasdaq National Market, or are foreign issuers whose securities meet the quantitative designation criteria for listing on a national securities exchange or the Nasdaq National Market. These entities have broad public ownership and their securities may be purchased by any investor. The NASD believes that an exemption for publicly traded entities

recognizes the practical limitations in attempting to identify every beneficial owner of a publicly traded entity and that the benefits of investments in new issues are, indirectly, shared by the public shareholders.

The original proposal would have exempted "[a] publicly traded corporation"<sup>127</sup> (other than an affiliate of a broker/dealer) listed on an exchange or The Nasdaq Stock Market, in which no person with a 10% or more ownership interest is a restricted person." Three commenters objected to the 10% proviso; they argued that the publicly traded entity exemption should resemble the exemption for registered investment companies and U.S. employee benefit plans in not requiring member firms to "look through" an entity to determine whether the beneficial owners were restricted persons.<sup>128</sup> The NASD agreed with these commenters and eliminated the "look through" provision.

As originally proposed, the publicly traded entity exemption did not extend to entities listed on a foreign exchange. One commenter stated that limiting the exemption to publicly traded entities listed on U.S. markets would unfairly discriminate against foreign companies.<sup>129</sup> A second commenter recommended an exemption for an initial equity offering in the United States by an issuer whose equity is publicly traded in another country.<sup>130</sup> In Amendment No. 3, the NASD expanded the proposed exemption to permit purchases of new issues by a publicly traded foreign entity so long as that entity meets the quantitative designation criteria for listing on a national securities exchange or the Nasdaq National Market.

The publicly traded entity exemption would not apply to a publicly traded broker-dealer or an affiliate of the broker-dealer where the broker-dealer is authorized to engage in the public offering of new issues either as underwriter or as a selling group member. Although the shareholders of such publicly traded entities would indirectly receive some of the benefit of

<sup>118</sup> Sullivan expressed concern that the general exemptions, in the form proposed in Amendment No. 2, applied only to the persons specified in the proposed rule and did not extend to the *accounts* of such persons. The NASD agreed that the general exemptions should clearly state that they apply to the specified persons as well as to the accounts of such persons, and revised the proposal accordingly.

<sup>119</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>120</sup> See NASD IM-2110-1(f)(1).

<sup>121</sup> See paragraphs (c)(2)(A) and (c)(3)(A) of proposed NASD Rule 2790.

<sup>122</sup> See paragraphs (c)(2)(B) and (c)(3)(B) of proposed NASD Rule 2790.

<sup>123</sup> See Mayer Brown.

<sup>124</sup> See Sidley 2.

<sup>125</sup> *Id.*

<sup>126</sup> See Fried.

<sup>127</sup> One commenter pointed out that the text of the original proposal referred only to publicly traded *corporations* and suggested that the exemption be extended to legal persons other than corporations. See Rosenman. The NASD agreed and revised the proposed rule text accordingly.

<sup>128</sup> See Colish; Sidley; Sullivan ("because \* \* \* publicly traded corporations are not likely to be used by restricted persons as vehicles for investments in hot issues, NASD members should be spared the administrative burden of confirming the restricted person ownership of customers that are publicly traded corporations").

<sup>129</sup> See Sidley.

<sup>130</sup> See Fried 2.