

IPO purchases, the NASD does not believe that allowing such purchases would be consistent with the purposes of the rule. The version of the publicly traded entity exemption proposed in Amendment No. 3 could have been construed to permit, for example, the holding company parent of a broker-dealer to purchase new issues, even if the broker-dealer engaged in a significant amount of investment banking business. The NASD stated that this was never the intent of the proposed exemption. Therefore, in Amendment No. 4, the NASD revised the public entity exemption to apply only to publicly traded entities that are not affiliated¹³¹ with a broker-dealer engaged in the public offering of new issues.

The NASD believes that looking to whether a broker-dealer is authorized to engage in public offerings¹³² excludes from the publicly traded entity exemption the “full service” broker-dealers and their parent companies that the rule is designed to reach. On the other hand, the proposed rule would allow purchases of new issues by the many publicly traded entities that have broker-dealer affiliates established for limited corporate purposes. The NASD believes that looking into whether a broker-dealer affiliate participates in offerings of new issues is one of many possible tests for determining the scope of the publicly traded entity exemption. The NASD stated that it also considered looking at the percent of profits or revenues a parent holding company derives from broker-dealer activities, but concluded that such information is often difficult to determine and frequently varies from year to year.¹³³

¹³¹ The NASD also stated in Amendment No. 4 that an “affiliate” for purposes of this provision would have the same meaning as in NASD Rules 2710 and 2720.

¹³² Under NASD member admission rules, a broker-dealer that seeks authority to engage in public offerings must make that part of its membership application. If an existing NASD member that is not authorized to engage in public offerings seeks to do so in the future, such member must make an application under NASD Rule 1017. In Amendment No. 4, the NASD stated that it intends to look to whether a firm is authorized to engage in public offerings of new issues, and that the information on Form BD may help firms identify broker-dealers that are authorized to engage in public offerings. The NASD noted, however, that the information on Form BD will not be conclusive since Item 12 does not require an activity to be reported if it is less than 1% of annual revenue.

¹³³ In Amendment No. 5, the NASD offered the following example of how the publicly traded entity exemption would work in conjunction with the basic restriction on broker-dealers and their affiliates. Assume that a parent company is publicly traded and has a broker-dealer subsidiary that engages in public offerings. The publicly traded parent company would be restricted under paragraph (i)(11)(E) of the rule and would not

One commenter argued that purchases by a private company also should be exempt from the proposed rule, if no more than 10% of its shareholders are restricted persons.¹³⁴ The NASD responded that a private company may avail itself of the *de minimis* exemption in paragraph (c)(4).

Finally, one commenter¹³⁵ pointed out that the Nasdaq Stock Market currently has an application pending with the Commission to become registered as a national securities exchange pursuant to Section 6 of the Act.¹³⁶ If that application is approved, securities traded in both the Nasdaq National Market and the Nasdaq SmallCap Market would be deemed to be traded on a national securities exchange. The commenter stated that the distinction set forth in paragraphs (c)(5)(A) and (B) between a security that is “listed on a national securities exchange” versus one that is “traded on the Nasdaq National Market” could create confusion as to whether securities traded on the Nasdaq SmallCap Market are exempt from the rule. In Amendment No. 5, the NASD stated that the publicly traded entity exemption does not apply to securities traded on the Nasdaq SmallCap Market. In addition, the NASD represented that it would consider amending the publicly traded entity exemption if and when Nasdaq becomes a national securities exchange.

d. *Foreign Investment Companies.* The Interpretation contains a general exemption for foreign investment companies.¹³⁷ A “foreign investment company” is defined as a fund company organized under the laws of a foreign jurisdiction that has certified that: (1) The fund has 100 or more investors; (2) it is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority; (3) no more than 5% of its assets are invested in a particular hot issue; and (4) no person owning more than a 5% interest in such

qualify for the publicly traded entity exemption. All accounts in which such parent company had a beneficial interest (including entities in which the parent held an interest of 10% or more) also would be restricted persons, even if the business of the subsidiaries was wholly unrelated to the broker-dealer activities. Now assume that the publicly traded parent company has a broker-dealer subsidiary that does not engage in public offerings. The parent company would qualify for the publicly traded entity exemption in paragraph (c)(5) of the rule. The broker-dealer subsidiary would continue to be a restricted person, but the parent company and other non-restricted subsidiaries of the parent company would be eligible to purchase new issues.

¹³⁴ See Sullivan.

¹³⁵ See Sidley 2.

¹³⁶ 15 U.S.C. 78f.

¹³⁷ See NASD IM-2110-1(f)(1).

company is a restricted person.¹³⁸ Paragraph (c)(6) of the proposed rule would preserve this exemption, but reduce from four to two the number of criteria that a foreign fund would be required to meet. Under the proposed rule, the investment company must be listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority, and no person owning more than 5% of the shares of the investment company may be a restricted person.¹³⁹ However, as the NASD clarified in Amendment No. 5, a foreign investment company that failed to meet one or both of the criteria for the exemption in paragraph (c)(6) might still qualify for the *de minimis* exemption in paragraph (c)(4).

One commenter¹⁴⁰ suggested exempting any foreign investment company that is traded on a “designated offshore securities market,” as defined in Rule 902(b) under the Securities Act.¹⁴¹ The NASD believes that such an exemption would be too broad and that the definition in Rule 902(b) is not related to the concerns underlying the proposed rule. Moreover, although noting that qualifying as a “designated offshore securities market” requires oversight by a governmental or self-regulatory body, the NASD is not confident that such regulation would prevent restricted persons from using foreign investment companies to circumvent the proposed rule. The NASD believes that, because it is difficult to compare foreign investment company laws to those in the United States, particularly as they relate to the purposes of the proposed rule, it is necessary to impose specific conditions on foreign investment companies to qualify for a general exemption.

In a second letter, the same commenter reiterated its recommendation that the proposed rule exempt foreign investment companies that are traded on a “designated offshore securities market” because managers of foreign investment companies might be unable to determine whether any 5%

¹³⁸ See NASD IM-2110-1(l)(6).

¹³⁹ The NASD believes that condition (1) in the Interpretation—the 100-investor requirement—addresses the same concerns about concentration of ownership as condition (4). Therefore, the NASD has decided to eliminate the 100-investor requirement. In addition, the NASD believes that condition (3)—the limitation on the size of the purchase in relation to the size of the investment company—is unnecessary and potentially burdensome for members to calculate. The NASD has stated, moreover, that for very large funds the limitation is meaningless, inasmuch as 5% of their total assets would often exceed the size of the entire IPO. Therefore, the NASD has decided to eliminate condition (3).

¹⁴⁰ See MSDW.

¹⁴¹ 17 CFR 230.902(b).