

shareholder is a restricted person due to foreign privacy laws preventing them from obtaining the necessary ownership information.¹⁴² Similarly, two other commenters suggested that the NASD eliminate the second requirement of the exemption—that no person owning more than 5% of the foreign investment company be a restricted person “because of the difficulties in ascertaining the ownership of a foreign investment company.”¹⁴³ Despite these concerns, the NASD believes that this requirement is necessary to prevent purchases of new issues by funds in which restricted persons have concentrated ownership interests.

e. *ERISA Plans.* Paragraph (c)(7) would provide a general exemption for benefit plans established under the Employee Retirement Income Security Act (“ERISA”) that are qualified under Section 401(a) of the Internal Revenue Code.¹⁴⁴ However, this exemption would not cover ERISA plans sponsored solely by a broker-dealer. The exemption as originally proposed also would have prevented an affiliate of a broker-dealer from using this exemption. Several commenters objected to this provision, arguing that they were unaware of any perceived or actual abuses to cause the NASD to narrow the exemption from the Interpretation.¹⁴⁵ The NASD agreed, and the final proposal would allow an ERISA plan sponsored by a broker-dealer affiliate—although not a plan sponsored by the broker-dealer itself—to benefit from the exemption.

f. *State and Municipal Government Benefits Plans.* Paragraph (c)(8) would provide a general exemption for a state or municipal government plan that is subject to state and/or municipal regulation.

g. *Tax-Exempt Charitable Organizations.* Paragraph (c)(9) would exempt sales of new issues to, and purchases by, tax exempt charities organized under Section 501(c)(3) of the Internal Revenue Code.¹⁴⁶ The NASD believes that new issue sales to charitable organizations are consistent with the purposes of the rule and foster a *bona fide* public distribution.

h. *Church Plans.* Paragraph (c)(10) would provide a general exemption for church plans described in Section 414(e) of the Internal Revenue Code.¹⁴⁷ As originally proposed, the rule included an exemption only for ERISA

plans. One commenter stated that the same rationale for exempting ERISA plans also applied to church plans, and recommended that the NASD exempt such plans as well.¹⁴⁸ The NASD agreed and added the new paragraph (c)(10) in Amendment No. 3.

i. *Foreign Employee Benefits Plans.* The same commenter also recommended that the proposed rule include a general exemption for foreign governmental and foreign non-governmental employee benefits plans.¹⁴⁹ The commenter argued that foreign plan participants are not in a position to influence the investment decisions of the plan sponsor even if they might otherwise be restricted persons. The commenter further noted that a number of foreign benefits plans are sponsored by foreign subsidiaries of U.S. corporations, and that a restriction on foreign plans could have illogical results: A U.S.-based employee of a foreign firm might participate in a U.S. plan that is permitted to buy new issues, while an American co-worker based in a foreign country who invests in a foreign plan would not be allowed to participate through the foreign plan in new issue allocations.

In Amendment No. 3, the NASD stated that it had declined to adopt a blanket exemption for foreign employee benefit plans. Since that time, however, the NASD has granted an exemption from the Interpretation to a pension fund operated by the province of Québec. The NASD stated that it granted this exemption on the basis of the large number of plan participants and the small notional *pro rata* allocation of each of the fund's assets to any individual participant. Nevertheless, the NASD does not believe that a blanket exemption for foreign plans would be appropriate. In some cases, the NASD observed, foreign laws may permit benefit plans to allocate new issues only to certain plan participants, may provide for unequal distribution of profits from new issues, or may benefit a very narrow category of restricted person. The NASD stated that it also may be possible for a foreign benefits plan to be constructed as a means to circumvent the rule; for example, a shell corporation that consists entirely or principally of restricted persons could establish a benefits plan that would purchase new issues. The NASD stated in Amendment No. 4 that, as its staff becomes more familiar with various types of foreign investment plans, it may consider issuing additional guidance in this area.

Finally, the NASD has stated that a foreign employee benefits plan that did not receive a specific exemption from the NASD staff could purchase new issues if it qualified for the *de minimis* exemption in paragraph (c)(4).

5. Issuer-Directed Securities

The Interpretation provides that employees and directors of an issuer, a parent of an issuer, a subsidiary of an issuer, or any other entity that controls or is controlled by an issuer, may purchase securities that are part of a public offering that are specifically directed by the issuer to such persons.¹⁵⁰ The Interpretation extends this exemption to potential employees and directors who would result from an intended merger, acquisition, or other business combination. The Interpretation requires, however, that the securities acquired pursuant to the exemption be subject to a three-month lock-up period if a *bona fide* independent market for such securities does not exist.

Under its original proposal, the NASD would have revised the provisions on issuer-directed securities in two principal ways. First, the scope of the exemption would have been extended to include employees and directors of sister companies. The NASD stated that such action would be consistent with the purposes of the rule and the existing exemption, as well as decisions of the NASD staff rendered pursuant to its exemptive authority. Second, the three-month lock-up period in the Interpretation would have been eliminated. The NASD believes that issuers should be free to set the conditions for sales of their own securities to their employees (or employees of affiliated companies) even if such employees are otherwise restricted persons. While an issuer may decide to impose a lock-up period, the NASD does not believe that such a period should be mandated by the proposed rule. The NASD has stated that eliminating the lock-up period would relieve members of having to investigate the status of employees and directors of the issuer and its affiliated companies, which was previously necessary solely to comply with the lock-up provision. This approach would allow all employees and directors of the issuer and affiliated companies to purchase securities of the issuer on equal terms. By contrast, under the Interpretation, an employee of an issuer who has a spouse in the securities industry must lock up a purchase of a

¹⁴² See MSDW 2.

¹⁴³ See Colish; Sullivan.

¹⁴⁴ 29 U.S.C. 401(a).

¹⁴⁵ See MSDW; SIA; Sullivan.

¹⁴⁶ 29 U.S.C. 501(c)(3).

¹⁴⁷ 29 U.S.C. 414(e).

¹⁴⁸ See CII.

¹⁴⁹ See *id.*

¹⁵⁰ See NASD IM-2110-1(d).