

believe that a decision to defer recognition of earnings for income tax purposes should alter the analysis of whether a person has a beneficial interest in a collective investment account.

b. *Collective Investment Account.* Paragraph (i)(2) would define "collective investment account" as any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale of securities. The original proposal defined "collective investment account" as any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that manages assets of other persons. One commenter pointed out that a hedge fund or other investment partnership typically engages in the purchase and sale of securities for its proprietary account, and that these entities do not necessarily manage the assets of others.<sup>172</sup> This commenter recommended, therefore, that the NASD remove the phrase "that manages the assets of other persons" from the definition. The NASD agreed and revised the proposed definition accordingly.

### C. Transition Period

Three commenters urged the NASD to allow entities that would be subject to the proposed rule a transition period before coming into full compliance with it.<sup>173</sup> The NASD believes that a transition period would be reasonable and has proposed a three-month period during which members could comply with either the Interpretation or the new rule. This three-month period would begin upon the NASD's publication of a Notice to Members announcing any Commission final action on the proposed rule change. The NASD stated in Amendment No. 5 that it would publish this Notice to Members no later than 60 days following a Commission approval.

## V. Discussion

After carefully considering the proposal and all the comments received, the Commission finds that the proposal, as amended, is consistent with the requirements of the Act and the regulations thereunder applicable to a national securities association. In particular, the Commission believes that the proposal is consistent with Sections 15A(b)(6) and 15A(b)(9) of the Act.<sup>174</sup>

Section 15A(b)(6) requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest. Section 15A(b)(6) also provides that the rules of an association may not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 15A(b)(9) provides that the rules of an association may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission finds that the proposal will protect investors and is in the public interest. The Commission believes that the proposal is a reasonable means of furthering the NASD's stated aims of ensuring that: (1) NASD members make a *bona fide* public offering of securities at the public offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward certain persons who are in a position to direct future business to the member; and (3) industry insiders, including NASD members and their associated persons, do not take advantage of their "insider" position to purchase new issues for their own benefit at the expense of public customers.

The proposal is to a large extent a reorganization of the existing provisions of NASD IM-2110-1. The Commission has previously opined on many of these provisions and found them to be consistent with the Act.<sup>175</sup> Furthermore, the Commission believes that the proposal furthers the purposes of the Act by making the rule easier to understand and administer. With respect to provisions of new NASD Rule 2790 that were not present in the Interpretation, the Commission finds that they also are consistent with the Act. The most significant of these new provisions are discussed below.

### A. Offerings Covered by NASD Rule 2790

The Commission believes that it is reasonable for the new rule to apply to "new issues" rather than "hot issues." Under the Interpretation, restrictions are

not triggered unless an issue becomes "hot" (*i.e.*, it trades at a premium over the offering price). The Commission believes that NASD members generally will find it simpler to treat all new issues in the same manner. The Commission also believes it reasonable to eliminate the cancellation provision; its primary rationale no longer exists because all new issues are subject to the rule from the moment that they are initially offered to the public, not later when they become "hot." Eliminating the cancellation provision will enhance compliance with the new rule by encouraging NASD members to identify all potential restricted persons prior to a new issue.

### B. Restricted Persons

The Commission believes that the scope of the term "restricted person" in the new rule is reasonable and consistent with the Act. As under the Interpretation, broker-dealers and their associated persons will be restricted. The Commission finds that it is consistent with the Act for the NASD to restrict its members from purchasing new issues from or selling new issues to other broker-dealers. The acquisition by such persons of new issues could give the appearance that an initial public offering was not in fact truly "public." The Commission also believes it is appropriate for the NASD to extend the restriction to agents of a broker-dealer who are engaged in the investment banking or securities business.

Under the new rule, as under the Interpretation, "limited business broker-dealers" (*i.e.*, broker-dealers that are authorized to engage only the purchase and sale of investment company/variable contracts securities and direct participation program securities) will not be considered restricted persons. The Commission believes that this provision is consistent with the Act because it exempts only a small class of broker-dealers that, due to the nature of their business, are unlikely to benefit unfairly from the purchase of a new issue.

The Commission has carefully considered CBOE's comment letter and finds that the NASD's decision not to expand the concept of limited business broker-dealers to include CBOE market makers and floor brokers (and their associated persons) is reasonable. CBOE argued that "options market makers and floor brokers perform specialized, limited functions and should not be considered representative of the typical broker-dealer population." However, the NASD's determination not to make additional exemptions for CBOE members and other types of broker-

<sup>175</sup> See, e.g., Securities Exchange Act Release No. 40001 (May 18, 1998), 63 FR 28535 (May 26, 1998) (SR-NASD-97-95) (approving various revisions to NASD IM-2110-1); Securities Exchange Act Release No. 35059 (December 7, 1994), 59 FR 64455 (December 14, 1994) (SR-NASD-94-15) (same).

<sup>172</sup> See Sidley.

<sup>173</sup> See Ropes (suggesting 90 days); Schulte (six months); Sullivan 2 (90 days).

<sup>174</sup> 15 U.S.C. 78o-3(b)(6) and (9).