

due to their nature, should be filed as a proposed rule change.

The first provision relates to paragraph (a)(4)(C) of Rule 2790, which provides an exclusion for "purchases by a broker/dealer (or owner of a broker/dealer), organized as an investment partnership, of a new issue at the public offering price, provided such purchases are credited to the capital accounts of its partners in accordance with paragraph (c)(4)." This exclusion is intended to allow a hedge fund that registers as a broker-dealer or that has a subsidiary that is a broker-dealer⁵ to purchase new issues on the same terms as other investment partnerships. For instance, pursuant to paragraph (a)(4)(C), a JBO hedge fund may purchase new issues so long as the beneficial interests of restricted persons do not exceed in the aggregate 10% of the fund. The NASD recognizes that there are a number of legal structures that a JBO hedge fund can take. Accordingly, the *Notice* will state:

Paragraph (a)(4)(C) refers specifically to "investment partnership" because we understand this is the most common organizational form of JBO hedge funds. We believe, however, that the decision to organize as a limited liability company, or some other corporate form, should not undermine the relief granted to hedge funds organized as JBOs or with JBO subsidiaries.

The second provision relates to the preconditions for sale in a fund-of-funds context. Paragraph (b) of Rule 2790 provides, in relevant part, that a member may not sell new issues to any account unless within the previous 12 months it has in good faith obtained a representation from either: (1) The beneficial owners of the account, or a person authorized to represent the beneficial owners of an account, that the account is eligible to purchase new issues in accordance with the rule; or (2) certain conduits (such as a bank, foreign bank, broker-dealer, or investment adviser) that all purchases of new issues are in compliance with the rule.

In a fund-of-funds context, a member must obtain a representation only from a person authorized to represent the beneficial owners of the fund/account that purchases new issues directly from the member ("master fund"). However, in making such a representation, a representative of the master fund would need to ascertain the status of investors of any feeder funds that invest in the master fund. In ascertaining the status of investors of any feeder funds, the NASD

will allow the representative of the master fund to rely on information from any feeder fund. To address the practicalities of the certification process, the *Notice* will state:

While the Rule specifies that a member must verify the status of the master fund annually, the Rule does not specify a time period during which a master fund may rely on information from a feeder fund. NASD recognizes that logistical impracticalities may prevent all authorized representatives of feeder funds from verifying information at the same time as the representative of the master fund. Thus, NASD will allow the representative of a master fund to rely on information from any feeder fund that is no more than 12 months old. Similarly, the representative of a feeder fund that in turn receives investments from other feeder funds may rely on information that is no more than 12 months old.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,⁶ which requires, among other things, that the NASD's rules be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; and, in general, to protect investors and the public interest. The NASD believes that its Rule 2790, as described herein, protects investors and the public interest by: ensuring that members make a bona fide public offering of securities at the public offering price; ensuring that 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 ensuring that industry "insiders," including members and their associated persons, do not take advantage of their "insider" position in the industry to purchase new issues for their own benefit at the expense of public customers.

B. Self-Regulatory Organization's Statement on Burden on Competition

The NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The NASD has designated the proposed rule change as "non-controversial" pursuant to Section 19(b)(3)(A) of the Act⁷ and Rule 19b-4(f)(6) thereunder.⁸ The NASD has represented that the proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. Rule 19b-4(f)(6) also requires the self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The NASD fulfilled the five-day pre-filing notice requirement.

The NASD has requested that the Commission waive the 30-day pre-operative waiting period, which would make the proposed rule change operative immediately. The Commission believes that it is consistent with the protection of investors and the public interest to waive the 30-day pre-operative period in this case because the proposed rule change provides additional guidance to investors regarding the application of NASD Rule 2790 and will facilitate the implementation of the new rule in the time frame described in the approval order.⁹ For these reasons, the Commission hereby waives the 30-day pre-operative period.¹⁰ Therefore, the proposal becomes operative immediately.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ 17 CFR 240.19b-4(f)(6).

⁹ See *supra* note 4.

¹⁰ For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁵ Certain hedge funds, or subsidiaries thereof, elect to become registered broker-dealers and share a back office with another broker-dealer. These entities are called joint back office broker-dealers ("JBOs").

⁶ 15 U.S.C. 78o-3(b)(6).