

associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (d)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (d)(2)(C)–(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (d)(2)(C)–(E).

[e] (j) Exemptions

Pursuant to the Rule 9600 Series, the [Association may exempt a member or person associated with a member from the provisions of this Rule] *appropriate NASD staff, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally grant an exemption from any provision of this Rule to the extent that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest.*

2720. Distribution of Securities of Members and Affiliates—Conflicts of Interest

(a) General

No Change.

(b) Definitions

(1)–(8) No Change.

(9) Immediate family—the parents, mother-in-law, father-in-law, [husband or wife] spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or

associated person of a member. In addition, the immediate family includes [or] any other person who [is supported, directly or indirectly, to a material extent by] either lives in the same household as, provides material support to, or receives material support from, an employee [of,] or associated person [associated, with] of a member.

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III. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

In January 2000, NASD filed with the SEC proposed amendments to the Corporate Financing Rule ("Rule") to modernize and simplify the Rule ("original proposal"). The SEC published the original proposal for comment on April 11, 2000¹⁸ and received 14 comment letters.¹⁹ In January 2001, NASD submitted Amendment No. 5 to the original proposal to respond to the comments ("amended proposal"). The SEC published the amended proposal for comment on March 14, 2001²⁰ and received 8 comment letters²¹ described later in this Section. Amendment Nos.

¹⁸ See *supra* note 6.

¹⁹ As stated previously, these comment letters are discussed in the release cited in note.

²⁰ See *supra* note 10.

²¹ Letters from Edward M. Alterman, Fried, Frank, Harris Shriver & Jacobson ("Fried Frank"), dated April 4, 2001; Goldman Sachs & Co. ("Goldman"), dated April 6, 2001; Michael T. Edsall, Kirkland & Ellis ("Kirkland"), dated April 4, 2001; Christine Walsh, First Vice President and Co-Head of Investment Banking Counsel Corporate and Institutional Client Group, Merrill Lynch ("Merrill"), dated April 12, 2001; John Faulkner, Managing Director, Morgan Stanley Dean Witter ("Morgan"), dated April 10, 2001; Stuart J. Kaswell, General Counsel and Senior Vice President, Securities Industry Association ("SIA"), dated April 6, 2001; Linda DeRenzo, Testa, Hurwitz & Thibault ("Testa"), dated April 3, 2001; and Morris N. Simkin, Winston & Strawn ("Winston"), dated February 27, 2001.

6 through 10 respond to the comments received.

The Corporate Financing Rule regulates underwriting compensation and prohibits unfair arrangements in connection with public offerings of securities. The Rule requires members to submit registration statements for public offerings and other supplemental information to the Corporate Financing Department ("Department") for review. In January 2000, NASD proposed comprehensive amendments to the Rule to modernize the Rule so that it would better reflect the various financial activities of multi-service firms.

The Commission has twice published for comment the proposed amendments. Commenters praised NASD for its decision to bring clarity and consistency to the application of the Rule. They also believed that the Rule should accommodate bona fide advisory and investment activities of NASD members while continuing to protect issuers and investors from unfair or unreasonable underwriting activities.

The original proposal contained an objective standard that members and the Department could follow to determine whether any "item of value," such as fees and securities received by underwriters and their affiliates should be included in the calculation of underwriting compensation under the Rule. Under this standard, all items of value received by participating members within the 180 day period before the filing of a registration statement and up to the time of the offering's effectiveness or commencement of sales (the "Review Period") would be included, unless the items were received in a transaction that met certain exceptions contained in the Rule. The exceptions are intended to distinguish securities and other items of value acquired as consideration for underwriting services from securities and other items of value acquired as consideration for venture capital investments and other financial services.

In the original proposal, securities acquired during the 90 days before the registration statement was filed would have been counted as compensation *per se*, notwithstanding whether their acquisition otherwise would meet an exception. Industry commenters strongly opposed the 90-day *per se* requirement and recommended the adoption of several alternative exceptions. They also recommended that the Department retain some flexibility under the Rule to make case-by-case determinations regarding whether certain items of value should be deemed to be underwriting compensation.