Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of DCC. All submissions should refer to File No. SR–DCC–97–10 and should be submitted by March 4, 1998.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[34]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–3367 Filed 2–10–98; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39620; File No. SR–NASD–97–95]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendment to the Free-Riding and Withholding Interpretation

February 4, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on December 23, 1997, NASD Regulation, Inc. (''NASD Regulation'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD Regulation is proposing to amend National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') Interpretative Material IM–2110–1 and Rule 2720, to revise certain aspects of the Free-Riding and Withholding Interpretation. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

IM–2110–1. ''Free-Riding and Withholding''

(a) Introduction

(1) No change.

(2) As in the case of any other interpretation issued by the [Board of Governors of the] Association, the implementation thereof is a function of the *NASD Regulation staff [District Business Conduct Committee] and the [Board of Governors] NASD Regulation Board of Directors.* Thus, the interpretation will be applied to a given factual situation by *NASD Regulation staff, subject to oversight by the Board, with staff soliciting input from* individuals active in the investment banking and securities business [who are serving on these committees or on the Board. They] *In making such interpretations, staff and the Board* will construe this interpretation to effectuate its overall purpose to assure a public distribution of securities for which there is a public demand.

* * * * *

(5) The NASD Regulation staff, upon written request, may, taking into consideration all relevant factors, provide an exemption either unconditionally or on specified terms from any or all of the provisions of this interpretation upon a determination that such exemption is consistent with the purposes of the interpretation, the protection of investors, and the public interest. A member may appeal a decision issued by NASD Regulation staff to the National Adjudicatory Council pursuant to the Code of Procedure.

* * * * *

(b) Violations of Rule 2110

(9) Sell any of the securities to any person, or to a member of the immediate family of such person, who owns or has contributed capital to a broker/dealer, other than solely a limited business broker/dealer as defined in paragraph (c) of the interpretation, or the account in which any such person has a beneficial interest, provided, however, that:

(A) The prohibition shall not apply to any person who directly or indirectly owns any class of equity securities of, or who has made a contribution of capital to, a member, and whose ownership or capital interest is passive and is less than 10% of the equity or capital of a member, as long as:

(i) such person purchases hot issues from a person other than the member in which it has such passive ownership and such person is not in a position by virtue of its passive ownership interest to direct the allocation of hot issues, or

(ii) such member's shares are publicly traded on an exchange or Nasdaq.

(B) This prohibition shall not apply to sales to the account of any person restricted under this subparagraph established for the benefit of bona fide public customers, including an insurance company general or separate account.

(C) For purposes of this paragraph, any person with an equity ownership or capital interest in an entity that maintains an investment in a member shall be deemed to have a percentage interest of the entity in the member multiplied by the percentage interest of such person in such entity.

* * * * *

(d) Issuer-Directed Securities

[(1) This interpretation shall apply to securities which are part of a public offering nothwithstanding that some or all of those securities are specifically directed by the issuer to accounts which are included within the scope of paragraph (b)(3) through (8) above. Therefore, if a person within the scope of those subparagraphs to whom securities were directed did not have the required investment history, the member would not be permitted to sell him such securities. Also, the ''disproportionate'' and ''insubstantial'' test would apply as in all other situations. Thus, the directing of a substantial number of securities to any one person would be prohibited as would the directing of securities to such accounts in amounts which would be disproportionate as compared to sales to members of the public. If such issuer-directed securities are sold to the issuer's employees or directors or potential employees or directors resulting from an intended merger, acquisition, or other business combination, such securities may be sold without limitation as to amount and regardless of whether such employees have an investment history as required by the interpretation; provided, however, that in the case of an offering of securities for which a bona fide independent market does not exist, such securities shall not be sold, transferred, assigned, pledged, or hypothecated for a period of three months following the effective date of the offering. This interpretation shall also apply to securities which are part of a public offering nothwithstanding that some of those securities are specifically directed by the issuer on a non-underwritten basis. In such cases, the managing underwriter of the offering shall be responsible for issuing compliance with this interpretation in respect to those securities.]

[34] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[(2) Notwithstanding the above, sales of issuer-directed securities may be made to non-employee/director restricted persons without the required investment history after receiving permission from the Board of Governors. Permission will be given only if there is a demonstration of valid business reasons for such sales (such as sales to distributors and suppliers, who are in each case incidentally restricted persons), and the member seeking permission is prepared to demonstrate that the aggregate amount of securities so sold is insubstantial and not disproportionate as compared to sales to members of the public, and that the amount sold to any one of such persons is insubstantial in amount; provided, however, that such securities shall not be sold, transferred, assigned, pledged, or hypothecated for a period of three months following the effective date of the offering.]

Employees or directors of an issuer, a parent of an issuer, a subsidiary of an issuer, or any other entity which controls or is controlled by an issuer, or potential employees or directors resulting from an intended merger, acquisition, or other business combination of an issuer otherwise subject to this interpretation in paragraphs (b)(2) through (9) may purchase securities that are part of a public offering that are specifically directed by the issuer to such persons; provided, however, that in the case of an offering of securities for which a bona fide independent market does not exist, such securities shall not be sold, transferred, assigned, pledged, or hypothecated for a period of three months following the effective date of the offering.

* * * * *

(f) Investment Partnerships and Corporations

(1) A member may not sell a hot issue to the account of any investment partnership or corporation, domestic or foreign (except companies registered under the Investment Company Act of 1940 *or foreign investment companies as defined herein*) including but not limited to hedge funds, investment clubs, and other like accounts unless the member complies with either of the following alternatives:

* * * * *

(2) No change

(3) An employee benefits plan qualified under The Employee Retirement Income Security Act shall be deemed restricted under the Interpretation in accordance with the following provisions:

(A) Any plan sponsored by a broker/dealer is restricted;

(B) Any plan sponsored by an entity that is not involved in financial services activities is not restricted whether or not any plan participants may be restricted;

(C) Any plan sponsored by an entity that is engaged in financial services activities, including but not limited to, banks, insurance companies, investment advisors, or other money managers, is not restricted, provided that the plan permits participation by a broad class of participants and is not designed primarily for the benefit of restricted persons.

* * * * *

(l) Explanation of Terms

The following explanation of terms is provided for the assistance of members. Other words which are defined in the By-Laws and Rules shall, unless the context otherwise requires, have the meaning as defined therein.

[(1) Associated Person

A person associated with a member or any other broker/dealer, as defined in Article I of the Association's By-Laws, shall not include a person whose association with the member is limited to a passive ownership interest in the member of 10% or less, and who does not receive hot issues from the member in which he or she has the ownership interest; and that such member is not in a position to direct hot issues to such person.]

([2]*1*) Public Offering

The term public offering shall mean any primary or secondary distribution of securities made pursuant to a registration statement or offering circular including exchange offers, rights offerings, offerings made pursuant to a merger or acquisition, straight debt offerings, and all other securities distributions of any kind whatsoever except any offering made pursuant to an exemption under Section 4(l), 4(2) or 4(6) of the Securities Act of 1933, as amended. The term public offering shall exclude exempted securities as defined in Section 3(a)(12) of the Act, *and debt securities (other than debt securities convertible into common or preferred stock) or financing instrument-backed securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories. The term public offering shall exclude secondary distributions by an issuer whose securities are actively-traded securities.*

([3]*2*) Immediate Family

The term immediate family shall include parents, mother-in-law or father-in-law, husband or wife, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children. In addition, the term shall include any other person who is supported, directly or indirectly, to a material extent by the member, person associated with the member or other person specified in paragraph (b)(2) above.

([4]*3*) Normal Investment Practice

Normal investment practice shall mean the history of investment of a restricted person in an account or accounts maintained by the restricted person. Usually the previous one-year period of securities activity is the basis for determining the adequacy of a restricted person's investment history. Where warranted, however, a longer or shorter period may be reviewed. It is the responsibility of the registered representative effecting the allocation, as well as the member, to demonstrate that the restricted person's investment history justifies the allocation of hot issues. Copies of customer account statements or other records maintained by the registered representative or the member may be utilized to demonstrate prior investment activity. In analyzing a restricted person's investment history the Association believes the following factors should be considered:

(A) The frequency of transactions in the account or accounts during that period of time. Relevant in this respect are the nature and size of investments.

(B) A comparison of the dollar amount of previous transactions with the dollar amount of the hot-issue purchase. If a restricted person purchases $1,000 of a hot issue and his account revealed a series of purchases and sales in $100 amounts, the $1,000 purchase would not appear to be consistent with the restricted person's normal investment practice.

(C) The practice of purchasing mainly hot issues would not constitute a normal investment practice. The Association does, however, consider as contributing to the establishment of a normal investment practice, the purchase of new issues which are not hot issues as well as secondary market transactions.

([5]*4*) Disproportionate

(A) In respect to the determination of what constitutes a disproportionate allocation, the Association uses a guideline of 10% of the member's participation in the issue, however

acquired. It should be noted, however, that the 10% factor is merely a guideline and is one of a number of factors which are considered in reaching determinations of violations of the interpretation on the basis of disproportionate allocations. These other factors include, among other things:

(i) The size of the participation;

(ii) The offering price of the issue;

(iii) The amount of securities sold to restricted accounts; and

(iv) The price of the securities in the aftermarket.

(B) It should be noted that disciplinary action has been taken against members for violations of the interpretation where the allocations made to restricted accounts were less than 10% of the member's participation. The 10% guideline is applied as to the aggregate of the allocations.

(C) Notwithstanding the above, a normal unit of trading (100 shares or 10 bonds) will in most cases not be considered a disproportionate allocation regardless of the amount of the member's participation. This means that if the aggregate number of shares of a member's participation which is allocated to restricted accounts does not exceed a normal unit of trading, such allocation will in most cases not be considered disproportionate. For example, if a member receives 500 shares of a hot issue, he may allocate 100 shares to a restricted account even though such allocation represents 20% of the member's participation. Of course, all of the remaining shares would have to be allocated to unrestricted accounts and all other provisions of the interpretation would have to be satisfied. Specifically, the allocation would have to be consistent with the normal investment practice of the account to which it was allocated and the member would not be permitted to sell to restricted persons who were totally prohibited from receiving hot issues.

([6]*5*) Insubstantiality

This requirement is separate and distinct from the requirements relating to disproportionate allocations and normal investment practice. In addition, this term applies both to the aggregate of the securities sold to restricted accounts and to each individual allocation. In other words, there could be a substantial allocation to an individual account in violation of the interpretation and yet be no violation on that ground as to the total number of shares allocated to all accounts. The determination of whether an allocation to a restricted account or accounts is substantial is based upon, among other things, the number of shares allocated and/or the dollar amount of the purchase.

(6) Foreign Investment Company

The term foreign investment company shall include any fund company organized under the laws of a foreign jurisdiction, which has provided to the member a written certification prepared by counsel admitted to practice law before the highest court of any state of the United States or such foreign jurisdiction, or by an independent certified public accountant licensed to practice in any state of the Untied States or such foreign jurisdiction, that states that:

(A) The fund has 100 or more investors;

(B) The fund is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority;

(C) No more than 5% of the fund assets are to be invested in the securities being offered, and,

(D) Any person owning more than 5% of the shares of fund is not a person described in subparagraphs (b)(1), (2), (3) or (4) of the Rule, (7) Actively-traded securities

(A) Actively-traded securities means securities that have an ADTV value of at least $1 million and are issued by an issuer whose common equity securities have a public float value of at least $150 million; provided, however, that such securities are not issued by the distribution participant or an affiliate of the distribution participant.

(B) ''ADTV'' means the worldwide average daily trading volume, during the two full calendar months immediately preceding, or any 60 consecutive calendar days ending within the 10 calendar days preceding, the filing of the registration statement, or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to Securities Act Rule 415, two full calendar months immediately preceding, or any consecutive 60 calendar days ending within the 10 calendar days preceding, the determination of the offering price.

* * * * *

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

[(m) Sales to Employees—No Limitations

Notwithstanding the provisions of IM–2110–1, ''Free-Riding and Withholding,'' a members may sell securities issued by a member, a parent of a member, an entity which who owns a member, an entity which owns (alone or in the aggregate with any wholly-owned, non-public subsidiary) at least 51% of the outstanding voting stock of a member or by an issuer treated as a member or parent of a member under paragraph (i) hereof to the member's employees' potential employees resulting from an intended merger, acquisition, or other business combination of members resulting in one public successor corporation; persons associated with the member; and the immediate family of such employees or associated persons without limitation as to amount and regardless of whether such persons have an investment history with the member as required by IM–2110–01; provided, however, that in the case of an offering of equity securities for which a bona fide independent market does not exist, such securities shall not be sold, transferred, assigned, pledged, or hypothecated for a period of five months following the effective date of the offering.]

([n]*m*) Filing Requirements; Coordination With Rule 2710

(1) Notwithstanding the provisions of Rule 2710 relating to factors to be taken into consideration in determining underwriter's compensation, the value of securities of a new corporate member succeeding to a previously established partnership or sole proprietorship member acquired by such member or person associated therewith, or created as a result of such reorganization, shall not be taken into consideration in determining such compensation.

(2) All offerings of securities included within the scope of this Rule shall be subject to the provisions of Rule 2710, and documents and filing fees relating to such offerings shall be filed with the Association pursuant to the provisions of that Rule. The responsibility for filing the required documents and fees shall be that of the member issuing securities, or, in the case of an issue of an affiliate, the managing underwriter or, if there is none, the member affiliated with the issuer.

(3) All offerings included within the scope of this Rule are required to be filed with the Association, with the appropriate documents and filing fee referred to under subparagraph (2), above, notwithstanding the fact that the offering may otherwise be expressly exempted from filing under the provisions of Rule 2710.

([o]*n*) Predominance of Rule 2720

If the provisions of this Rule are inconsistent with any other provisions

of the Association's By-Laws or Rules, or of any interpretation thereof, the provisions of this Rule shall prevail.

([p]*o*) Requests for Exemption From Rule 2720

Pursuant to the Rule 9600 Series, the Association may in exceptional and unusual circumstances, taking into consideration all relevant factors, exempt a member unconditionally or on specified terms from any or all of the provisions of this Rule which it deems appropriate.

([q]*p*) Violation of Rule 2720

A violation of the provisions of this Rule shall constitute a violation of Rule 2110, and possibly other Rules, especially Rules 2120 and 2310, as the circumstances of the case may indicate.

II. Self-Regulatory Organizations Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

In its filling with the Commission, NASD Regulation 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 Regulation 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

(a) Purpose

(i) Overview of the Free-Riding and Withholding Interpretation. The Free-Riding and Withholding Interpretation (''Interpretation'') protects the integrity of the public offering system by ensuring that members make a bona fide public distribution at the public offering price of ''hot issue'' securities and do not withhold such securities for their own benefit or use such securities to reward other persons in the financial services business who are in a position to direct future business to the member. Improperly withholding securities or directing securities to other persons in the financial services business who can direct future business to the member leads to an impairment of public confidence in the fairness of the investment banking and securities business. The Interpretation also assures that members and participants in the securities industry do not take unfair advantage of their inside position in the industry to the detriment of public investors.

(ii) Notice to Members 97–30 (May 1997). In March 1997, the NASD Regulation Board of Directors (''Board''), acting upon recommendation from the National Business Conduct Committee (''NBCC''),[2] considered various amendments to the Interpretation. The Board submitted a series of proposed rule amendments to the membership for comment in Notice to Members 97–30 (''NTM 97–30''). The Board also decided that it would be appropriate to examine the entire Interpretation in the context of current market conditions and sought comment on whether the Interpretation could be simplified and made easier to follow.

NASD Regulation received 22 comment letters. Most of the commenters did not address every proposed rule amendment, but only selected issues. The proposed rule amendments, the comments received, and NASD Regulation's response to the comments are set forth below.

(A) Treatment of Direct and/or Indirect Owners of Broker/Dealers

In 1994, NASD Regulation amended the Interpretation's definition of ''associated person'' to exempt certain passive investors in broker/dealers.[3] NASD Regulation now proposes further amendments to the Interpretation to address two limitations from the previous amendments. First, the definition of associated person as currently provided in the Interpretation does not include non-natural persons that have an ownership interest in or have contributed capital to a broker/dealer.[4] Second, the Interpretation does not affirmatively specify any ownership levels at which a natural person becomes an associated person by reason of his ownership interest in a broker/dealer. The Interpretation only states when a natural person is *not* an associated person. In NTM 97–30, NASD Regulation staff proposed modifying the Interpretation to create a new definition of ''restricted person'' that would include natural and non-natural persons that own or contribute capital to a broker/dealer, subject to two exceptions. The first exception was for passive investors that own or have contributed 10 percent or less of the firm's equity or capital and who purchase from a member other than the member in which they maintain the ownership interest, provided that the member in which they maintain the ownership interest is not in a position to direct issues to the owner or contributor. The second exception was for persons who passively own 10 percent or less of the shares of broker/dealers that are traded on an exchange or Nasdaq.

The proposal also stated that indirect investors should be treated the same as direct investors. To determine whether an indirect investor meets the 10 percent threshold, noted above, the proposed amendment provided that the percentage of the direct investment is multiplied by the percentage interest in the investing entity. For example, an investor with a 50 percent investment in a investment partnership that in turn owns 18 percent of the equity capital of a broker/dealer would be deemed to own 9 percent of the broker/dealer for the purposes of the Interpretation.

Generally, the commenters did not object to the application of the Interpretation to non-natural persons, but were concerned that as drafted, the Interpretation would preclude purchases of hot issues by any entity that owns 10 percent or more of a broker/dealer, or any account in which such entity had a beneficial interest. The commenters stated that these problems arose primarily due to the breadth of paragraph (b)(5) of the Interpretation, which prohibits sales of hot issues to any account in which a restricted person has a beneficial interest. Several commenters stated that the proposed revisions would have the effect of prohibiting participation in hot issues by all entities within many insurance companies in which a parent company owns 10 percent or more of a broker/dealer. By way of example, one suggested that the Interpretation, as proposed, would preclude companies such as the American Insurance Group from purchasing hot issues for any account in which they have a beneficial interest.

This result was not intended when NTM 97–30 was proposed, and NASD Regulation staff has revised the amendments to address these concerns. To avoid the effects of (b)(5), the proposed amendments no longer seek to redefine the term ''restricted person.'' Rather, new paragraph (b)(9)(A) has been created which expressly prohibits sales to any person, or any account in which such person has a beneficial

[2] The name of this committee has been changed to National Adjudicatory Council, *See* Securities Exchange Act Release No. 39470 (December 19, 1997), 62 FR 67927 (December 30, 1997).

[3] Securities Exchange Act Release No. 35059 (December 7, 1994), 59 FR 64455, 64457 (December 14, 1994).

[4] *See In re Rocena Company, Ltd.*, No. C07950042, National Business Conduct Committee, 1997 NASD Discip. LEXIS 12, (NBCC January 8, 1997) (holding that a non-natural person is not considered an associated person for purposes of the Interpretation).

interest, who owns or has contributed capital to a broker/dealer, other than a limited purpose broker/dealer, with broad exceptions for passive ownership interests less than 10 percent. These provisions are consistent with the proposal in NTM 97–30. New paragraph (b)(9)(B) has been created to respond to the concerns of several commenters that the amendments proposed in NTM 97–30 would prohibit sales of hot issues to all entities within many insurance companies that own a broker/dealer. Paragraph (b)(9)(B) exempts sales of hot issues to any account established for the benefit of bona fide public customers of a person restricted pursuant to this subparagraph. The exception expressly notes that such accounts would include, but are not limited to, an insurance company's general or separate accounts. Lastly, new paragraph (b)(9)(C) retains the indirect ownership provisions proposed in NTM 97–30.

Commenters also stated that the amendments proposed in NTM 97–30 would, by virtue of paragraph (b)(5), prohibit many bank holding companies and industrial companies such as Ford and General Electric, or any account in which such companies have a beneficial interest, from purchasing hot issues because these companies have a wholly-owned broker/dealer subsidiary. NASD Regulation does not agree with the commenters that these entities should be able to purchase not issues for their proprietary accounts because passing on the benefits of hot issue purchases to shareholders is not equivalent to passing on benefits directly to bona fide public customers. Accordingly, these persons would be restricted from purchasing hot issues pursuant to proposed paragraph (b)(9). However, as discussed below in section (F), the Employment Retirement Income Security Act accounts of bank holding companies and industrial companies such as Ford and General Electric would normally be able to purchase hot issues.

Another commenter asked if the proposed definition would preclude investment partnerships that have an equity stake in a broker/dealer from purchasing hot issues. This commenter argued that such investment partnerships should be able to purchase hot issues subject to the restrictions in paragraph (g) of the Interpretation. NASD Regulation does not believe that the purposes of paragraph (g) of the Interpretation are to permit investment partnerships that own 10 percent or more of a broker/dealer to purchase hot issues. The paragraph (g) ''carve out'' methodology permits investment partnerships in which restricted persons have a beneficial interest to purchase hot issues so long as the profits from the hot issues are not allocated to any restricted persons. An investment partnership that is not otherwise restricted and accepts an investment from a person that is restricted pursuant to paragraph (b)(9) would be able to purchase hot issues as long as hot issue profits are segregated from the restricted person pursuant to the criteria of paragraph (g).

The Securities Industry Association (''SIA'') did not object to the proposed definition of ''restricted person,'' but instead suggested that NASD Regulation use the existing definition of the term ''affiliate'' from Rule 2720(b)(1). The SIA favored using the definition of ''affiliate'' because it established a rebuttable presumption of control. Another commenter noted that the term ''restricted person was already used throughout the Interpretation and redefining it would cause confusion. NASD Regulation does not believe that a rebuttable presumption would be a useful concept in the context of the Interpretation. However, NASD Regulation appreciates that redefining the term ''restricted person'' as originally proposed may create confusion and has removed that term from the current proposal.

Finally, one commenter argued that the Interpretation should be modified to provide exemptions for passive investors who contribute 10 percent or less of a broker/dealer's capital, but did not see any ''constructive purpose'' in holding investors in privately held firms to a different and ''tougher'' standard than investors in publicly traded firms. NASD Regulation believes as a general matter that publicly traded firms are less susceptible to influence by passive owners or investors than private firms and, thus, an exemption for such firms is appropriate. Passive owners or investors in private firms can purchase hot issues as long as they meet the criteria in paragraph (b)(9)(A)(i).

(B) Rated Investment Grade Debt

Currently, debt offerings are included in the definition of ''public offering'' in the Interpretation. In NTM 97–30, NASD Regulation proposed excluding rated investment grade debt offerings from the Interpretation on the ground that such offerings do not raise the same issues as equity offerings inasmuch as the price for a particular debt security generally fluctuates based on interest rate movements rather than demand factors. Based upon this rationale, NASD Regulation staff proposed an exception for ''non-convertible debt securities rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.''

This proposal was enthusiastically supported by many of the commenters. Many commenters, however, urged NASD Regulation to go further. One commenter stated that all debt offerings should be excluded. The SIA and PSA The Bond Market Trade Association (''PSA'') agreed with the proposal but argued that NASD Regulation should adopt a ''functional'' standard that would exempt all ''investment grade securities that trade primarily on the basis of yield and credit quality.'' NASD Regulation staff does not support a ''functional'' standard because it provides less clarity than the current proposal and would be difficult to administer. The SIA and PSA also both argued that certain convertible securities may be converted into a security other than common stock and that such convertible securities should be exempt from the Interpretation. Other commenters proposed modifying the exclusion to also include financing instrument-backed securities and various forms of convertible securities. NASD Regulation proposes modifying the exclusion for debt securities to include financing instrument-backed securities and convertible debt securities as long as they are not convertible into common or preferred stock. Although these revisions are likely to affect only a few persons, they appear consistent with the rationale for excluding rated investment grade debt.

(C) Exemptive Authority Under the Interpretation

Presently, there is no provision in the Interpretation to allow for the NBCC, the Board, or NASD Regulation staff to grant general exemptive relief. In the past, the NBCC, relying on the NASD By-Law's grant of authority to the Board and its Committees, has provided exemptions in certain unique circumstances. NASD Rule 9600 delegates exemptive authority in the Interpretation to the Office of General Counsel. The Interpretation currently provides for exemptive relief solely in cases involving sales of issuer-directed securities to non-employee/director restricted persons pursuant to paragraph (d)(2). In NTM 97–30, NASD Regulation stated that it believed that it was important to provide express authority to grant exemptions in individual cases, and proposed amendments accordingly. These amendments grant NASD Regulation staff the authority to provide exemptions, subject to oversight by the Board. The proposed amendments also provide that persons may appeal

decisions of NASD Regulation staff to the NBCC.

All of the comments received on this issue expressed support for this proposal. The text of the proposed amendment has been modified for consistency with Rule 9610 and to reflect the renaming of the National Business Conduct Committee to the National Adjudicatory Council.

(D) Foreign Mutual Funds

Purchases of shares of investment companies registered under the Investment Company Act of 1940 are exempt from the Interpretation based upon the rationale that the interest of any one restricted person in an investment company ordinarily is de minimis and because ownership of investment company shares generally is subject to frequent turnover, determining compliance with the Interpretation would be extremely difficult.

NASD Regulation proposed in NTM 97–30 to extend this rationale to the purchase of shares of foreign investment companies. In particular, NASD Regulation proposed exempting sales of hot issues to a foreign investment company if such foreign investment company provides written certification from a U.S. attorney or accountant stating that: (1) The fund has 100 or more shareholders; (2) the fund is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority; (3) no more than 5 percent of the fund's securities assets are invested in the securities being offered, and; (4) any person owning more than 5 percent of the shares of the fund is not a restricted person as defined in subparagraphs (b)(1) through (b)(4) of the Interpretation. These amendments seek to create roughly equivalent standards between U.S. and foreign investment companies.

All of the comments received on this issue strongly supported an exemption from the Interpretation for foreign investment companies. The commenters, however, did not necessarily agree with the proposed attestation procedures. Many of the commenters stated that the requirement for a member to provide a written certification would impose a substantial administrative burden and cost. The SIA took the position that attestation should not be required at all. A few commenters stated that if written certification is to be required, then a foreign attorney or accountant should be able to make such certification because many foreign investment companies may be reluctant to hire U.S. counsel or accountants. NASD Regulation agrees that foreign attorneys and accountants should be able to make the required attestations and has modified the proposed amendments accordingly.

A number of comment letters also suggested that rather than obtaining a written certification from the foreign investment company each time before a member permits it to purchase in an initial public offering that may become a hot issue, the NASD should develop a centralized electronic repository containing certifications that would be accessible to members. NASD Regulation preliminarily supports such an idea but believes that it raises a number of issues that deserve consideration, including who would operate the repository. NASD Regulation proposes communicating to the private sector its willingness to consider applications by firms interested in maintaining a centralized repository of foreign investment companies as well as any investment partnerships or corporations that qualify to purchase hot issues pursuant to paragraph (f) of the Interpretation. NASD Regulation also may consider operating the system itself. The operator of such a central repository must be concerned with maintaining accurate and current information, since the participants in these investment vehicles and their status under the Interpretation is likely to change from time to time. NASD Regulation agrees that a centralized repository may be an efficient and effective method of maintaining certifications, but believes that investment companies should be permitted to purchase hot issues subject to the verification procedures outlined in NTM 97–30, as modified above, while NASD Regulation considers the implementation of a centralized repository.

(E) Secondary Offerings

Primary and secondary distributions of securities are currently included in the definition of ''public offering'' under the Interpretation. In NTM 97–30, NASD Regulation proposed maintaining secondary offerings subject to the Interpretation based upon statistical evidence that approximately 33 percent of secondary offerings trade at a premium, even though such premium is generally small.

A number of commenters did not believe that the Interpretation should apply to secondary offerings. Generally, these commenters noted that secondary offerings rarely trade at a premium to the market and even then, the premium often is very small. One commenter suggested an exemption for secondary equity offerings of widely-held issuers with established secondary markets provided that such secondary offerings are not priced at a significant discount to the current market. This commenter also urged NASD Regulation to adopt changes that were consistent with the SEC's new Regulation M. Similarly, the SIA stated that the Interpretation should not apply to any secondary offerings and in the alternative, that NASD Regulation should exempt offerings of liquid issues at appropriate thresholds.

NASD Regulation has reconsidered its earlier position and now proposes an exemption for secondary offerings similar to the Regulation M exception for actively-traded securities (which are defined as securities that have an average daily trading volume of at least $1 million and are issued by an issuer whose equity securities have a public float of at least $150 million). In light of the SEC's decision to except actively-traded securities from its trading practice rules, NASD Regulation believes that it is appropriate to exempt similarly defined securities from the Interpretation with respect to secondary offerings.

(F) Accounts for Qualified Plans Under The Employment Retirement Income Security Act (''ERISA'')

Currently, there are no provisions in the Interpretation that expressly address the status of qualified employee benefit plans under ERISA. While NASD Regulation deferred proposing any specific amendments to NTM 97–30 with respect to ERISA plans, it noted that there were two frequently asked questions: whether a qualified ERISA plan is considered an investment partnership or corporation under paragraph (f) of the Interpretation; and, if so, whether the ''carve out'' mechanism described in paragraph (g) could permit sales to be made to qualified ERISA accounts. NASD Regulation stated in NTM 97–30 that it believes as a general rule that a qualified ERISA plan should not be deemed an ''investment partnership or corporation'' and should not be considered a ''restrict account.'' NASD Regulation added that the NBCC has suggested the following methodology to determine under what circumstances a qualified ERISA plan would be deemed restricted:

(i) Any plan sponsor that is not involved in financial services activities would not be considered restricted even though some plan participants may be restricted.

(ii) Any plan sponsored by a broker/dealer would be deemed per se restricted.

(iii) All other financial services plans, including those involving banks,

insurance companies, investment advisors, or other money managers, would be exempt unless they had been created to circumvent the purposes of the Interpretation, including where a financial services plan had only restricted persons as beneficiaries.

NASD Regulation received only one comment on ERISA plans. The SIA stated that an ERISA plan sponsored by a broker/dealer should be restricted only with respect to the plan's transactions with such broker/dealer. NASD Regulation believes that the SIA's proposal is inconsistent with the purposes of the Interpretation and has declined to make the modification. However, NASD Regulation believes that it would be helpful to clarify the status of accounts for qualified plans under ERISA and is proposing to include the NBCC interpretation as part of IM–2110–1, with minor stylistic modifications.

(G) Issuer-Directed Share Exemption

Paragraph (d) of the Interpretation contains provisions relating to issuer-directed securities plans. In 1994, paragraph (d) was amended to allow members to allocate hot issues to restricted persons who also were employees of the issuer, without having to receive prior approval of the NBCC, NASD Regulation believes that issuer-directed securities programs are a valuable tool in employee development and retention, and are not likely to pose the risk of members using these securities to reward other persons who are in a position to direct future business to the member. In NTM 97–30, NASD Regulation stated that persons have requested that the language of paragraph (d) be modified to clarify that the exemption is available to employees of the issuer who are materially supported by a restricted person and both employee and non-employee directors. Several commenters also welcomed clarification to the issuer-directed securities exception provisions more generally. Based upon the comments received and its own initiative to clarify and streamline the issuer-directed securities provisions more generally, NASD Regulation proposes modifying paragraph (d) of the Interpretation to permit persons associated with a member and their immediate family members to purchase hot issues. The proposed amendments would apply the issuer-directed share exemption to persons subject to the Interpretation in paragraphs (2)–(9), instead of paragraphs (3)–(9) as currently written. NASD Regulation believes that this is consistent with the purposes of the issuer-directed exemption. In addition, by expanding the scope of restricted persons that can purchase hot issues under proposed paragraph (d) to include persons restricted under paragraph (b)(2), NASD Regulation is incorporating the exemption for issuer directed offerings of NASD members currently found at Rule 2720(m), which pertains to conflicts of interest in connection with the distribution of securities of members and affiliates.

The proposed amendments to the issuer-directed provisions also would clarify that exemptions apply to employees and directors of a parent or subsidiary of the issuer, consistent with NASD Regulation's past practice. Specifically, the proposed amendments exempt ''a parent of an issuer, a subsidiary of an issuer, or any other entity which controls or is controlled by an issuer.'' While no specific percentage is mentioned to establish a control relationship, NASD Regulation believes that a guideline of 50 percent should be used and is consistent with provisions of former Rule 2720(m). Employees and directors of sister corporations to the issuer would not be subject to an exemption for issuer-directed securities, but could request exemptive relief under paragraph (a)(5), which as noted above, provides NASD Regulation with exemptive authority. Further, the proposed amendments would shorten the lock-up period for persons formerly covered under Rule 2720(m) from five months to three months for consistency and simplicity. The five month lock-up period specified in Rule 2720(m) is an historical anomaly (pertaining to taxation issues) and the purposes of the Interpretation would not be frustrated if the lock-up period for all persons was three months. NASD Regulation has observed substantial confusion concerning the application of the Interpretation to issuer directed offerings and believes that these revisions will assist members with their compliance responsibilities.

In addition, because of the proposal to grant plenary exemptive authority to NASD Regulation as noted above in item (c), there is no longer any need for paragraph (d)(2), which grants to the Board of Governors limited authority to exempt sales of issuer-directed securities to non-employee/director restricted persons. Accordingly, this paragraph has been deleted.

(H) General Comments

A few of the commenters addressed NASD Regulation's broad question whether ''the Interpretation could be simplified and made easier to follow.'' These commenters generally believed that more should be done to streamline the Interpretation. The SIA stated the Interpretation has been ''pulled and stretched'' beyond its original purpose and now has become a set of provisions that try to address a host of abuses relating to possible conflicts of interest and self-dealing in the offering process. The SIA believed that many of these other issues are already addressed by interpretations of what constitutes ''just and equitable principles of trade,'' or elsewhere in the securities laws. Another commenter stated this was the second major review of the Interpretation in the last three years and that the changes adopted three years ago as well as those proposed in NTM 97–30 represent only minor adjustments to an ''overly complex and burdensome rule.'' Both commenters stated that compliance with the Interpretation was time-consuming and costly.

NASD Regulation agrees that the Interpretation is overly complex in many respects. NASD Regulation is committed to a wholesale modification of the Interpretation following these proposed rule changes. NASD Regulation believes that the exemption for certain debt and secondary offerings and the modifications to the issuer directed share provisions provide greater clarity to the Interpretation and will reduce the burdens of compliance for many members. NASD Regulation plans to continue its review of the entire Interpretation to consider other ways in which it may be simplified. NASD Regulation has communicated this goal to members of the industry and plans to begin working on broad reform once the current amendments are in place.

(I) Miscellaneous

In NTM 97–30, NASD Regulation requested comment on several other issues for which it did not suggest any proposed amendments to the Interpretation. These topics were non-member broker/dealers and their associated persons, de minimis exemption, limited purpose broker/dealers, and member verification of conduit for undisclosed principal. NASD Regulation will consider the comments received on these issues as it begins broad reform of the Interpretation.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15a(b)(6) of the Act,[5] in that it will promote just and equitable principles of trade, prevent fraudulent and manipulative acts and

[5] 15 U.S.C. 78*o*–3.

practices, and protect investors and the public interest, by facilitating the bona fide distribution of hot issue securities to the public, and protecting against the receipt of hot issues by persons in the financial services business who are in a position to direct future business to the member, or who have an unfair advantage due to their inside position in the industry. Further, NASD Regulation believes that the proposed changes and clarifications to the Interpretation are consistent with Section 15A(b)(9) in that they alleviate certain inequities caused by the Interpretation, which imposed burdens on competition not necessary or appropriate in furtherance of the purposes of the Act.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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, as amended.

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

The proposed rule change was published for comment in NASD Notice to Members 97–30 (May 1997). Twenty-two comments were received in response to the notice. The position of the commenters and their specific comments are discussed above in section II(A).

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number SR–NASD–97–95 and should be submitted by March 4, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[6]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39619; File No. SR–PHLX–98–01]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Concerning Notice to Persons Who are the Subject of a Report to the Exchange Business Conduct Committee

February 3, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b-4[2] thereunder, notice is hereby given that on February 3, 1998, the Philadelphia Stock Exchange, Inc. (''PHLX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PHLX proposes to amend Exchange Rule 960.2 to adopt new subsection (e), Notice and Statement, to codify the Exchange's practice of notifying persons who are the subject of an investigative report, which will be reviewed by the Business Conduct Committee, and to give those persons the opportunity to submit a written statement to the Business Conduct Committee prior to the Business Conduct Committee's review of the investigative report. The text of the proposed rule change is below. Brackets represent deletions; italicizing represents additions.

Complaint and Investigation

Investigation and Authorization of Complaint

Rule 960.2 (a)–(d) No change.

(e) Notice and Statement. Prior to submitting its report, the staff shall notify the person(s) who is (are) the subject of the report (''Subject'') of the general nature of the allegations and of the specific provisions of the Exchange Act, rules and regulations promulgated thereunder, or constitutional provisions, by-laws or rules of the Exchange or any interpretation thereof or any resolution of the Board regulating the conduct of business on the Exchange, that appear to have been violated. The staff shall also inform the Subject that the report will be reviewed by the Committee. The Subject may then submit a written statement to the Committee concerning why no disciplinary action should be taken. To assist a Subject in preparing such a written statement, he shall have access to any documents and other materials in the investigative file of the Exchange that were furnished by him or his agents.

[(e)] *(f)* Determination to Initiate Charges.

No change.

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

In its filing with the Commission, the PHLX 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. The PHLX 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

In April of this year, the Exchange's Board of Governors adopted the recommendation of the Governance

[6] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1) (1994).

[2] 17 CFR 240.19b-4 (1997).