



Securities Industry Association

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September 24, 2002

Barbara Z. Sweeney
Office of the Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Re: Notice to Members 02-55; IPO Allocations

Dear Ms. Sweeney,

The Capital Markets Committee of the Securities Industry Association (“SIA”)¹ appreciates the opportunity to comment on the NASD’s proposed new Rule 2712 (IPO Allocations and Distributions) and proposed amendment to Rule 2710 (Corporate Financing Rule) as set out in Notice to Members 02-55.² The proposed rules are intended to prohibit the conditioning of IPO allocations on the receipt of excessive compensation for other services, agreements to purchase in the aftermarket, or the assignment of future investment banking business to the member. There are also provisions to prohibit penalizing registered representatives whose customers have flipped IPO shares unless a penalty bid has been imposed on that member and to require members to file information regarding allocations of IPO shares to officers and directors of a company that hires the member to be book-running managing underwriter of the company’s IPO.

SIA supports the efforts of the NASD to enact rules designed to ensure that its members avoid unacceptable conduct when they engage in the allocation and distribution of IPO’s. As the NASD notes, the federal securities laws (i.e., rules 10b-5, Regulation M) and existing NASD rules (i.e., Rule 2110, 2710, 2330, 3010 and 3060) already prohibit certain IPO allocation abuses. Nevertheless, the new and specifically targeted provisions in Rule 2712 would aid member compliance efforts and help to maintain investor confidence in the capital markets. On the whole, the proposal properly identifies specific allocation practices to be prohibited without unintentionally interfering with legitimate activities of underwriters and without imposing unnecessary costs and burdens on NASD Member firms. Subject to the relatively minor changes and clarifications described in more detail below, SIA is in favor of the proposed rule changes.

¹ The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly **93 million** investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States. (More information about SIA is available on its home page: <http://www.sia.com> .)

² <http://www.nasdr.com/pdf-text/0255ntm.txt>

General Comments

The U.S. capital-raising process is based on a book-building system by which underwriters attempt to build a book of potential orders for the new offering over a several-week marketing period prior to the beginning of trading. This system has worked remarkably well. Last year, U.S. underwriters raised \$2.5 trillion for companies. Over the past 10 years, underwriters have raised over \$12 trillion. The unprecedented expansion of our economy over the last century and our preeminent position as the world's industrial leader would not have been possible without the capital raised by underwriters for new and existing businesses. Moreover, while other systems for raising capital – auction, subscription, pro-rata allocation - have been tried in other markets, none has been as successful or popular as book-building.

While markets will continue to behave in a cyclical manner, it is critical to remember that U.S. capital markets are the envy of the world and are both efficient and transparent. We support aggressively rooting out manipulative and fraudulent behavior, but we urge a balanced approach, such as that demonstrated by the present filing, to discussions of perceived structural flaws and possible regulatory responses. In this way we can ensure that the ups and downs of short-term market sentiment do nothing to undermine confidence in our time-tested and world-leading capital raising system.

Specific Comments

1. Proposed Rule 2712(a) would prohibit a member and its associated persons from offering or threatening to withhold an IPO allocation as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by the member.

SIA supports the provision, but has concerns regarding how “excessive” might be interpreted. For example, fees received for executing “commodity” type services such as executing secondary market trades can easily be benchmarked, whereas fees for other services are more highly negotiated because the services provided are much more customized.

We suggest changing the applicable standard to “clearly excessive” and including language to clarify that any finding should take into account all of the circumstances surrounding the services provided, including but not limited to, the uniqueness, creativity, risk and effort involved in the transaction or transactions, as well as the totality of the relationship between the customer and the member.

2. Rule 2712(b) would expressly prohibit a member or an associated person that is participating in an IPO from requesting that a customer purchase shares in the aftermarket as a condition to being allocated shares in the IPO.

SIA supports this provision as appropriate to deterring manipulation in the aftermarket. We believe the language of the proposed rule appropriately distinguishes solicitations of aftermarket interest as a pre-condition for IPO allocations, from

inquiries made by the underwriters regarding a potential customer's interest in owning shares of the issuer, as well as information volunteered by prospective buyers. Such expressions of ownership interest routinely include the number of shares that a buyer would like to own in the short and longer term and at what price levels. Such information is routinely gathered during the book-building process as part of the underwriter's price discovery process. This information is essential to making an accurate assessment of demand for a new offering, which is in turn essential to accurate pricing of the offering.

SIA recommends that the language in the discussion section clarify that such inquiries and discussions regarding a potential customer's interest in purchasing and holding a security are not deemed solicitations for purposes of this provision.

3. Rule 2712(c) would expressly prohibit a member and its associated persons from allocating IPO shares to an executive officer or director of a company on the condition that the executive officer or director, on behalf of the company, direct future investment banking business to the member.

As the discussion notes, the rule is not intended to prohibit a member from allocating IPO shares to a customer merely because the customer is an executive or director of a company. Broker-dealers built on a full-service model aspire to offer brokerage services to all employees of companies with whom they do business. In fact, executive officers and directors of newly or soon to be public companies, or start up companies that may be sold to more established companies, are precisely the type of potential high net worth customers that brokerage firms are most eager to develop as new clients as they often need investment advice, particularly with respect to diversifying their assets.

The SIA believes that the objective of this proposed rule is entirely appropriate, but, as with the definitional aspects of several of the proposed rules, we note that the line between what is "excessive" or what has been done as or on "a condition" or "as consideration" for something can be difficult to draw. The burden of proof should not fall on members to prove the absence of these factors in every transaction. Helpful language has been included in several parts of the proposing commentary clarifying the scope of these provisions. We believe that such language should be included in the actual rules and perhaps expanded. We would be happy to work with the NASD in drafting language that would provide even greater clarity to these rules in order to avoid a potentially "chilling" effect on activities that are recognized as legitimate and important aspects of our capital raising process.

4. Amendments to Rule 2710, the Corporate Financing Rule, would require members to file information regarding the allocation of IPO shares to executive officers and directors of a company that hires a member to be the book-running managing underwriter of the company's IPO.

SIA supports a rule requiring this information as necessary to enforcing proposed rule 2712(c) above. However SIA questions whether the burden for reporting one of the required elements is perhaps misplaced. Proposed Rule 2710 (b)(6)(A)(vii)(c) requires a statement indicating whether the executive officer or director participated in

any capacity in the selection of the book-running managing underwriter for the issuer's public offering. Underwriters cannot know with certainty which of the officers or directors of an issuer were involved in the selection, or the significance of their roles, and thus cannot realistically be expected to supply this information. Only the issuer can know this with any accuracy and we believe the burden for reporting it should appropriately fall on the issuer. Since the NASD only has jurisdiction over broker dealers, the only way to collect this information is to require that the book-running lead manager acquire a representation from the issuer as a condition to NASD review of the transaction. The member should not have any responsibility for verifying the accuracy of the issuer's representation.

SIA also believes that the requirement to file information under Rule 2710 with respect to the 180-day calendar period immediately following the effective date of the offering is extremely burdensome. The filing date of the offering is not a date that is tracked in any way and this information is difficult to collect. While we understand the role that collecting such information would play in permitting the NASD to potentially monitor allocations to detect potential "spinning" violations, we question whether the cost associated with providing such information and of the NASD entering into a usable surveillance system and allocating the resources to utilize such a system are justified on a cost-benefit basis.

Finally, SIA believes that, if this provision is enacted, there should be a sufficiently long implementation period to allow firms to notify brokerage clients of the new requirements, and, where necessary or appropriate, to obtain the consent of brokerage clients to the filing of this information with the NASD. Privacy rules both here and abroad will need to be studied to determine the extent of the notification and/or consent requirements and restrictions.

5. Rule 2712(d) would prohibit members from penalizing registered representatives whose customers have "flipped" IPO shares that they have purchased through the member, unless a penalty bid, as defined in Regulation M Rule 101, has been imposed on the member by the managing underwriter.

SIA supports this provision, but believes that the NASD may wish to clarify the scope of transactions or securities to which the provision applies. For example, the NASD may wish to specify definitionally that the shares covered include common stock in an initial public offering, other than one made by an investment company under the Investment Company Act of 1940.

SIA also believes that the time period specified in (d)(2)(A) should commence with the *offering date*, not the *effective date*. The offering date tracks the language used in the Agreement Among Underwriters (AAU), which is used by member firms to track the period in which the penalty bid may be used. The registration statement has an effective date; the offering does not, so it is unclear whether or not this refers to the effective date of the registration statement or the pricing date of the offering. Because Rule 430A permits an offering to be priced up to 15 days after the effective date, the pricing date would seem to more consistent with the policy objective here and consistent with the existing syndicate practices.

SIA appreciates the opportunity to address the proposed regulations and would be pleased to discuss their views further. If you have any questions about any of the positions taken in this letter, please contact Scott Kursman, Vice President and Associate General Counsel, at (212) 618-0508.

Very truly yours,

Kenneth L. Josselyn
Chair, Capital Markets Committee

Cc: Mary Schapiro, President, NASDR
Marc Menchel, General Counsel, NASD
Joseph Price, Director of Corporation Finance, NASD
Thomas Selman, Senior Vice President, NASD
Gary Goldsholle, Associate General Counsel, NASD

The Honorable Harvey L. Pitt, Chairman, SEC
The Honorable Roel C. Campos, Commissioner, SEC
The Honorable Cynthia A. Glassman, Commissioner, SEC
The Honorable Harvey J. Goldschmid, Commissioner, SEC
The Honorable Paul S. Atkins, Commissioner, SEC
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