



April 6, 2001

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Notice of Filing of Amendment No. 5 to a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to its Corporate Financing Rule; File No. SR-NASD-00-04 (April 11, 2000)

Dear Mr. Katz,

The Securities Industry Association ("SIA")¹ appreciates the opportunity to express its views on the proposed amendments to the NASD's Corporation Financing Rule (Rule 2710).

The NASD Corporation Finance Rule ("the Rule") is intended to ensure that the underwriting terms and arrangements of a public offering in which an NASD member participates are fair and reasonable. SIA commends the NASD on its efforts to bring clarity and consistency to the underwriting compensation review process. We strongly agree that the rule should accommodate the legitimate advisory and investing activities of NASD members while continuing to protect investors from unreasonable underwriting activities. We believe, however, that these goals can be achieved through a more narrowly tailored rule and offer our suggestions below.

General Comments

In SIA's previous comment letter on this proposal², we suggested creating an exemption from the rule for offerings of larger well-financed companies coming to the

¹ The Securities Industry Association brings together the shared interests of more than 680 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 more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

² Letter from Stuart J. Kaswell, Senior Vice President & General Counsel, SIA, to Jonathan Katz, Secretary, SEC, June 9, 2000, available at http://www.sia.com/2000_comment_letters/html/rule_2710_6-9.html

capital markets for the first time and companies that have met the qualifications for exchange listing. We regret that this recommendation was not considered as part of the re-proposal. SIA believes that the policy concerns underlying Rule 2710 are not present in the context of all offerings of securities covered by the rule and that there should be an exemption from the rule for larger transactions. Our previous letter cited vigorous competition among underwriters for issuance business and the difficulty of “retrofitting” a prior financing into one of the rule’s safe harbors as reasons for broadening the exemptions from the Rule.

Specific Comments

1. Definition of “Institutional Investor” (Paragraph (d)(4)(B)) – includes the proviso that “no participating member has an equity interest in or manages or otherwise directs the institutional investor’s investments.” This could be broadly interpreted to mean that the safe harbor is not available if the participating member has an equity interest in the specific investments of the institutional investor, as opposed to an interest in the institutional investing entity. We believe that the important element in the relationship between underwriter and institutional investor is the degree of control or management the underwriter exercises over the institutional investor.

Also, the term “participating member” is too broad for purposes of the proviso. An insurance company, pension fund or mutual fund may not qualify as an institutional investor, and would thus lose the benefit of the safe harbor, if any associated person of a participating member, or a member of the immediate family of such a person, had an investment with the insurance company, pension fund or mutual fund.

Recommendation: *revise the proviso to apply to participating members in a public offering that either directly or through an affiliate or associated person controls, manages or otherwise directs the institutional investor’s investments.*

2. Items of Value – Exclusion of cash compensation for financial advisory fees (Paragraph (c)(3)) – The NASD notes its intention to consider cash compensation for services on a case-by-case basis rather than exclude some or all of these fees outright. This arguably brings under NASD review any cash compensation received by a firm for financial advisory services, including advisory fees for abandoned offerings, portfolio hedging, and other services unrelated to the underwriting.

Recommendation: *include more examples of advisory fees under the exclusion for cash compensation.*

3. Items of Value - Listed Securities (Paragraph (c)(3)(B)(iv)) – The present exclusion applies only to listed securities purchased in a public market transaction. The exclusion is too narrow because there are other means by which the underwriter may transact with persons unaffiliated with the issuer.

Recommendation: *the exclusion should apply to securities purchased in an arms-length transaction from a person not affiliated with the issuer. Alternatively, include securities traded on Nasdaq NMS, Small Cap, Bulletin Board securities, exchanges listed in Rule 146 and foreign exchanges identified as offshore securities markets in SEC Rule 902(b) of Regulation S.*

4. Definition of Entity (Paragraph (d)(4)(A)) – In order to qualify as an entity for purposes of the paragraph (c)(5) exceptions, a group of legal persons must have made at least one co-investment together. Many investing fund entities replicate existing partnerships and funds in order to keep the number of participants or the dollar value of each fund manageable. The rule does not allow an investment by a participating member in an earlier version of the fund to qualify.

Recommendation: *the rule should treat as one entity each of the successor funds in a series of funds that are created on a regular basis to engage in the same business as prior funds in the series.*

5. Special Treatment of Insurance Companies and Banks (Paragraph (d)(5)(A)) – this section includes an exception from underwriting compensation for purchases and loans by certain entities that are related persons of underwriters. Among the entities that may use the exception are certain regulated insurance companies and banks, and by application of subparagraph (d)(4)(A)(ii), their wholly-owned subsidiaries. Underwriters and related persons who are not insurance companies or banks are subject to the standards of (d)(5)(A)(i)(a)(1) or (2), which are different and arguably more difficult to meet.

Recommendation: *To ensure that all underwriters are on an equal footing from a competitive standpoint, the exceptions for the two types of entities should be harmonized.*

6. Lock up Provisions (Paragraph (g)) – Applies to all securities held by a participating member whether the securities are deemed compensation or not. Even with the exceptions, this provision would constrain the investments of many individuals and entities with little or no relationship to the underwriting. This is a significant extension of the NASD's authority that would conflict with the SEC's jurisdiction over after-market activities of underwriters. Neither the NASD nor commenters to the previous proposal cited any concerns with this activity that would justify a new regulation. Finally, the rule does not include an examination of the respective costs and benefits of such a rule.

Recommendation: *limit the provisions to only those securities deemed compensation under the rule. Any proposal to further extend lockup provisions should be given more consideration by all parties involved.*

7. Lock up Provisions (paragraph (g)) – Participating members should not be prevented from selling stock received by a company that acquires (for stock) the newly underwritten company during the lock-up period.

Recommendation: *The NASD should clarify that the lock-up provisions do not apply to such sales of stock.*

8. Antidilution Rights (Paragraph (d)(5)(D)) – Additional shares received by a participating member or affiliate could fall under the rule by virtue of the exercise of anti-dilution rights.

Recommendation: *Acquisitions necessary to maintain an investor's ownership interest in a company should not be viewed as compensation to the underwriter.*

We appreciate the opportunity to comment on the proposal. If we can answer any questions or provide any further information, please contact Scott Kursman, Vice President & Associate General Counsel, at 212-618-0508.

Very truly yours,

Stuart J. Kaswell
General Counsel and
Senior Vice President

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