MEMO# 18952

June 17, 2005

DRAFT ICI COMMENT LETTER ON NASD PROPOSED RULE CHANGE RELATING TO RULE 2790

 [18952] June 17, 2005 TO: INTERNATIONAL COMMITTEE No. 12-05 INTERNATIONAL INVESTING SUBCOMMITTEE No. 1-05 RE: DRAFT ICI COMMENT LETTER ON NASD PROPOSED RULE CHANGE RELATING TO RULE 2790 The Securities and Exchange Commission has published for comment a proposed rule change filed by the NASD relating to Rule 2790,1 which generally prohibits an NASD member from selling a "new issue" to any account in which a "restricted person" has a beneficial interest. The Institute has prepared a draft comment letter on the proposal. The most significant aspects of the draft letter are summarized below and a copy of the draft letter is attached. Comments on the proposal are due to the SEC no later than June 22, 2005. If you have any comments on the draft letter, please contact the undersigned by phone at 202-371-5408 or by e-mail at aburstein@ici.org no later than June 21. Application of Rule 2790 to Foreign Investment Companies The draft letter discusses several reasons why the current exemption from Rule 2790 for foreign investment companies, particularly the condition in the exemption requiring that no person owning more than 5% of the shares of the investment company is a restricted person, is ineffectual in permitting these entities to invest in initial public offerings ("IPOs") in the U.S. securities market. Specifically, the draft letter states that it is not possible for a foreign investment company to identify all the beneficial owners of the fund, and how much of the fund they own, in order to determine whether any restricted person owns more than 5% of the fund for purposes of the exemption. This is due to the manner in which investors hold shares of foreign investment companies, the broad scope of the definition of "restricted person" under Rule 2790, and because shares of foreign investment companies are typically owned by a large number of individual shareholders. The draft letter notes that it also is not practical for foreign investment companies to provide a representation, as required under the rule, that all purchases of new issues are in compliance with the rule. 1 SEC Release No. 34-51735 (May 24, 2005), 70 FR 31554 (June 1, 2005). 2 The draft letter therefore recommends that the NASD change the current exemption for foreign investment companies to eliminate the provision relating to the beneficial ownership of "restricted persons" and, in general, redefine what constitutes a foreign investment company for purposes of the rule. In order to address concerns about preventing restricted persons from establishing investment companies and other investment vehicles abroad to circumvent Rule 2790, the draft letter recommends that the NASD require the investment adviser for the foreign investment company to have investment discretion over the account. The draft letter states that this

would, in effect, rule out the ability of restricted persons to influence the fund. In addition, in order to further ensure that restricted persons cannot circumvent the rule, the draft letter recommends explicitly requiring that the foreign investment company neither be created nor operated for the purpose of circumventing Rule 2790. Finally, in order to ensure that a foreign investment company is a public fund, the draft letter recommends that the NASD create a definition of a foreign investment company similar to that used by the SEC in its rule requiring the registration under the Investment Advisers Act of 1940 of certain hedge fund advisers. The draft letter states that this definition would address concerns regarding the application of the exemption only to those foreign investment companies that truly are offered to the public. Application of Rule 2790 to Foreign Pension Plans and Foreign Charitable Organizations The draft letter notes that Rule 2790 contains exemptions for pension plans and charitable organizations organized under applicable U.S. law but does not contain corresponding exemptions for foreign pension plans or foreign charitable organizations. For the reasons discussed in the draft letter in connection with the exemption for foreign investment companies, the draft letter recommends that the NASD amend the rule to provide workable exemptions to permit foreign pension plans and foreign charitable organizations to invest in IPOs in the U.S. securities market. Specifically, the draft letter recommends creating an exemption for foreign pension funds and foreign charitable organizations that would contain conditions requiring that these entities are created or organized under the laws of a foreign jurisdiction, are not created or operated for the purpose of circumventing Rule 2790, and are regulated, as applicable, by the foreign jurisdiction. Ari Burstein Associate Counsel Attachment (in .pdf format)
