

MEMO# 16819

November 26, 2003

NASD PROPOSES RULE AMENDMENTS TO PROHIBIT CERTAIN ABUSES IN THE ALLOCATION AND DISTRIBUTION OF INITIAL PUBLIC OFFERING SHARES

[16819] November 26, 2003 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 32-03 SEC RULES MEMBERS No. 167-03 SMALL FUNDS MEMBERS No. 72-03 RE: NASD PROPOSES RULE AMENDMENTS TO PROHIBIT CERTAIN ABUSES IN THE ALLOCATION AND DISTRIBUTION OF INITIAL PUBLIC OFFERING SHARES As we previously advised you, in October 2002, the NYSE/NASD IPO Advisory Committee was created at the request of the Securities and Exchange Commission to review the initial public offering (IPO) process and recommend changes necessary to address the problems that have been identified in the process.¹ Earlier this year, the Advisory Committee published its report, which identified harmful practices that have eroded public confidence in the integrity of the IPO process and recommended various revisions to address these practices. Pursuant to the Advisory Committee's recommendations, the NASD has proposed revisions to proposed Rule 27122 to implement the following recommendations of the Committee: • Require the lead managing underwriter to disclose indications of interest and final allocations to the issuer's pricing committee; • Prohibit acceptance of market orders (but not limit orders) to purchase IPO shares in the aftermarket for one trading day following an IPO; • Impose procedures designed to ensure that reneged IPO allocations are not used to benefit favored clients of the underwriter; • Require that any lock-up that applies to shares owned by the issuer's officers and directors also applies to shares they purchase in "friends and family" programs; and • Impose new notification requirements when underwriters waive lock-ups. 1 See Memorandum to Equity Markets Advisory Committee [16158] No. 13-03, SEC Rules Members No. 68-03, and Small Funds Members No. 25-03, dated June 4, 2003. 2 See NASD Notice to Members 03-72 (November 2003) ("NTM-03-72"). A copy of NTM 03-72 is available on the SEC's website at: <http://www.nasdr.com/pdf-text/0372ntm.pdf>. Rule 2712 was originally proposed by the NASD for comment in August 2002. In September 2003, this proposed rule was filed with the SEC, where it is pending. NTM 03-72 proposes amendments to the pending rule. 2 In addition to seeking comment on these revisions, NTM 03-72 seeks comment on various additional regulatory requirements that could be imposed on underwriters in order to promote transparency in IPO pricing. These including requiring underwriters to: • Retain an independent broker-dealer to opine that the initial IPO price range at which the offering is marketed and the final offering price are reasonable and require the inclusion of this opinion in the issuer's prospectus; • Use an auction or other system to collect indications of interest to help establish the final IPO price; or • Include a "valuation disclosure" section in the prospectus with information about how the managing

underwriter and issuer arrived at the initial price range and final IPO price, such as the issuer's one-year projected earnings or price/earnings ratios and share price information of comparable companies. The Institute does not plan to comment on the revisions to proposed Rule 2712. Persons interested in commenting on the proposal must submit their comments to the NASD as directed in NTM 03-72 no later than January 2, 2004. Tamara K. Salmon Senior Associate Counsel

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