MEMO# 18966

June 22, 2005

ICI COMMENT LETTER ON NASD PROPOSAL RELATING TO RULE 2790

 [18966] June 22, 2005 TO: INTERNATIONAL MEMBERS No. 20-05 INTERNATIONAL INVESTING SUBCOMMITTEE No. 3-05 RE: ICI COMMENT LETTER ON NASD PROPOSAL RELATING TO RULE 2790 The Institute has filed a comment letter with the Securities and Exchange Commission on 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 most significant aspects of the comment letter are summarized below and a copy of the letter is attached. Application of Rule 2790 to Foreign Investment Companies The 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 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 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. The letter therefore recommends that the NASD change the current exemption for foreign investment companies to eliminate the condition 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 letter recommends that the NASD instead require as a condition of the exemption that the investment adviser for the foreign investment company have investment discretion over the 1 SEC Release No. 34-51735 (May 24, 2005), 70 FR 31554 (June 1, 2005). 2 account. The 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 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 the exemption is limited only to those funds that are available to the public, the letter recommends that the NASD amend

the first part of the exemption and 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 letter states that this definition would clarify the scope of the exemption in a more efficient manner than the proposed amendment and would promote uniformity between NASD and SEC rules relating to what constitutes a publicly offered foreign investment company. Application of Rule 2790 to Foreign Pension Plans and Foreign Charitable Organizations The 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 letter in connection with the exemption for foreign investment companies, the 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 letter recommends creating exemptions 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) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 18966, or call the ICI Library at (202) 326-8304 and request the attachment for memo 18966.
