

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50749; File No. SR-NASD-2004-022)

November 29, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Corporate Financing Rule and Shelf Offerings of Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 4, 2004, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On May 4, 2004, NASD filed Amendment No. 1 to its proposed rule change, which replaced and superseded the original rule filing in its entirety. On July 16, 2004, NASD filed Amendment No. 2 to its proposed rule change.<sup>3</sup> On October 12, 2004, NASD filed Amendment No. 3 to its proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

**I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

NASD is proposing to amend NASD Rules 2710, 2810, IM-2440, and Schedule A to the NASD By-Laws to address the filing requirements and the regulation of public offerings of securities registered with the Commission and offered by members pursuant to SEC Rule 415 of Regulation C under the Securities Act of 1933 (“SEC Rule 415”)

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 2 made several technical corrections and modified the Market Transactions Exception contained in the proposed rule change.

<sup>4</sup> Amendment No. 3 corrected clerical and typographical errors contained in Amendment No. 2.

(“shelf offerings”). Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in [brackets].

### **Schedule A to NASD By-Laws**

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of NASD shall be determined on the following basis.

**Sections 1 through 6** - No change.

### **Section 7 - Fees for Filing Documents Pursuant to the Corporate Financing Rule**

(a) There shall be a fee imposed for the initial filing of [initial] documents and information relating to any offering filed with NASD pursuant to the Corporate Financing Rule equal to \$500 plus .01% of the proposed maximum aggregate offering price or other applicable value of all securities registered on an SEC registration statement or included on any other type of offering document (where not filed with the SEC), but shall not exceed \$30,500. The amount of filing fee may be rounded to the nearest dollar.

(b) There shall be an additional fee imposed for the filing of any amendment or other change to the documents and information initially filed with NASD pursuant to the Corporate Financing Rule equal to .01% of the net increase in the maximum aggregate offering price or other applicable value of all securities registered on an SEC registration statement, or any related Rule 462(b) registration statement, or reflected on any Rule 430A prospectus, or included on any other type of offering document. However, the aggregate of all filing fees paid in connection with an SEC registration statement or other type of offering document shall not exceed \$30,500.

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## **IM-2440. Mark-Up Policy**

The question of fair mark-ups or spreads is one which has been raised from the earliest days of the Association. No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association's Board adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943. Pursuant thereto, and in accordance with Article VII, Section 1(a)(ii) of the By-Laws, the Board has adopted the following interpretation under Rule 2440.

It shall be deemed a violation of Rule 2110 and Rule 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.

(a) through (b) No change.

### **(c) Transactions to Which the Policy is Applicable**

The Policy applies to all securities handled in the over-the-counter market, whether oil royalties or any other security, in the following types of transactions:

(1) through (5) No change.

(6) Transactions in which a member sells securities from an offering registered with the SEC pursuant to SEC Rule 415 that comply with the exemption from filing with NASD under Rule 2710(b)(10)(B) for Market Transactions.

### **(d) Transactions to Which the Policy is Not Applicable**

The Mark-Up Policy is not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price[.], including any offering or transaction subject to the compensation limitations of Rule 2710 or Rule 2810.

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## **2710. Corporate Financing Rule -- Underwriting Terms and Arrangements**

### **(a) Definitions**

For purposes of this Rule, the following terms shall have the meanings stated below. The definitions in Rule 2720 are incorporated herein by reference.

(1) through (2) No Change.

### **(3) Offering Proceeds**

The maximum [P]public offering price of all securities to be offered or that are sold in a public offering [to the public], not including securities subject to any overallotment option, securities to be received by the underwriter and related persons, or securities underlying other securities.

(4) No Change.

### **(5) Participation or Participating in a Public Offering**

Participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, principal, agency or any other basis, participation in a shelf takedown that does not satisfy the requirements of the market transactions exemption; furnishing of customer and/or broker lists for solicitation, or participation in any advisory or consulting capacity to the issuer related to

the offering, but not the preparation of an appraisal in a savings and loan conversion or a bank offering or the preparation of a fairness opinion pursuant to SEC Rule 13e-3.

**(6) Underwriter and Related Persons**

Consists of underwriter’s counsel, financial consultants and advisors, finders, any participating member, and any other persons [related to any participating member] that receive any item of value that would be considered underwriting compensation.

**(7) Listed Securities**

Securities meeting the listing standards to trade on the national securities exchanges identified in SEC Rule 146, markets registered with the SEC under Sections 6 or 11A of the [Exchange] Act, and any offshore market that is a “designated offshore securities market” under Rule 902(b) of SEC Regulation S.

(8) through (9) No Change.

**(10) Required Filing Date**

The required filing date shall be the dates provided in subparagraph (b)(4), and for a public offering exempt from filing under subparagraph (b)(7), the required filing date for purposes of subparagraphs (d) and (g) shall be the date the public offering would have been [be] required to be filed with [the] NASD but for the exemption.

**(11) Securities Act**

The Securities Act of 1933, as amended.

**(12) Shelf Offering**

Any offering of securities registered with the SEC and offered pursuant to SEC Rule 415, under the Securities Act.

**(13) Takedown**

In connection with a shelf offering, the securities purchased by a member in a principal transaction or the securities sold by a member in an agency transaction.

**(b) Filing Requirements**

(1) through (3) No change.

**(4) Requirement for Filing**

(A) Unless filed by the issuer, the managing underwriter, or another member, a member that anticipates participating in a public offering of securities subject to this Rule shall file with NASD the documents and information with respect to the offering specified in subparagraphs (5) and (6) below:

(i) No Change.

(ii) if not filed with or submitted to any regulatory authority, at least fifteen business days prior to the anticipated date on which offers will commence[.]; or

(iii) in the case of a shelf offering, before the member sells securities in any takedown required to be filed.

(B) No [sales of securities subject to this Rule shall commence] member shall commence selling in any offering required to be filed by this Rule, Rule 2720 or Rule 2810 unless:

(i) No Change.

(ii) NASD has provided an opinion to the member or that covers the member stating that it has no objections to the proposed underwriting and other terms and arrangements[ or an opinion that the proposed

underwriting and other terms and arrangements are unfair and unreasonable]. If NASD's opinion states that the proposed underwriting and other terms and arrangements are unfair and unreasonable, the member may file modifications to the proposed underwriting and other terms and arrangements for further review.

(C) Any member acting as a managing underwriter or in a similar capacity that has been informed of an opinion by NASD[,or a determination by the appropriate standing committee of the Board of Governors,] that the proposed underwriting terms and arrangements of a proposed offering are unfair or unreasonable, and the proposed terms and arrangements have not been modified to conform to the standards of fairness and reasonableness, shall notify all other members proposing to participate in the offering of that opinion or determination at a time sufficiently prior to the effective date of the offering or the commencement of sales so the other members will have an opportunity as a result of specific notice to comply with their obligation not to participate in any way in the distribution of a public offering containing arrangements, terms and conditions that are unfair or unreasonable.

(5) through (6) No Change.

**(7) Offerings Exempt from Filing**

Notwithstanding the provisions of subparagraph (1) above, documents and information related to the following public offerings need not be filed with NASD for review, unless subject to the provisions of Rule 2720. However, it shall be deemed a

violation of this Rule or Rule 2810, for a member to participate in any way in such public offerings if the underwriting or other arrangements in connection with the offering are not in compliance with this Rule or Rule 2810, as applicable:

(A) securities offered by a corporate, foreign government or foreign government agency issuer which has unsecured non-convertible investment grade rated debt with a term of issue of at least four (4) years, or unsecured non-convertible investment grade rated preferred securities, [rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories,] except that the initial public offering of the equity of an issuer is required to be filed[;].

(B) investment grade rated non-convertible debt securities and investment grade rated non-convertible preferred securities [rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories;].

[(C) offerings of securities:]

[(i) registered with the Commission on registration statement Forms S-3 or F-3 pursuant to the standards for those Forms prior to October 21, 1992 and offered pursuant to SEC Rule 415 adopted under the Securities Act of 1933, as amended; or]

[(ii) of a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory, and is registered with the Commission on Form F-10 pursuant to the standards for that



Form approved in Securities Act Release No. 6902 (June 21, 1991) and offered pursuant to Canadian shelf prospectus offering procedures;]

[(D)] (C) securities offered pursuant to a redemption standby "firm commitment" underwriting arrangement registered with the Commission on Forms S-3, F-3 or F-10 (only with respect to Canadian issuers)[;].

[(E)] (D) financing instrument-backed securities which are investment grade rated [by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories]; and

[(F)] (E) exchange offers of securities where:

(i) No change.

(ii) the company issuing securities qualifies to register securities with the Commission on registration statement Forms S-3, F-3, or F-10, pursuant to the standards for those Forms as set forth in [subparagraphs (C)(i) and (ii) of this paragraph; and] subparagraph 10(D) below; and

[(G)] (F) offerings of securities by a church or other charitable institution that is exempt from SEC registration pursuant to Section 3(a)(4) of the Securities Act.

(8) No change.

### **(9) Offerings Required to be Filed**

Documents and information relating to all other public offerings including, but not limited to, the following must be filed with NASD for review:

(A) through (H) No change.

(I) any exchange offer, merger and acquisition transaction, or other similar corporate reorganization involving an issuance of securities that results in the direct or indirect public ownership of the member; [and]

(J) any offerings of a similar nature that are not exempt under subparagraph (7) or (8) above[.]; and

(K) shelf offerings pursuant to paragraph (10) below, and any shelf offering that is the initial public offering of the equity of an issuer.

**(10) Shelf Offerings**

(A) Filing Requirement: a member that is required under subparagraph (4) above to file with NASD documents and information required in subparagraphs (5) and (6) shall make an “Initial Member Filing” or, if another member has made the Initial Member Filing, a “Subsequent Filing,” and shall receive a no-objections opinion pursuant to such filing prior to its participation in the shelf offering.

(i) Issuer Filing: Documents and information that are required to be filed by members under subparagraphs (5) and (6) may be filed by the issuer. The fees specified in Section 6 of Schedule A to the NASD By-Laws will be required in connection with such a filing;

(ii) Initial Member Filing: Unless made by another member, prior to participating in a shelf offering a member shall make an Initial Member Filing of the documents and information required under subparagraphs (5) and (6) and pay the filing fee specified in Section 6 of Schedule A to the NASD By-Laws prior to participating in a takedown. Documents and

Information previously provided to NASD in an Issuer Filing may be incorporated in the Initial Member Filing and no additional filing fees will be required if the entire filing fee has been paid in connection with an Issuer Filing;

(iii) Subsequent Member Filing: if the Initial Member Filing has been made in connection with a shelf offering, a member that has not already received a “no-objections” opinion under subparagraph (b)(4)(B) shall make a Subsequent Member Filing of the documents and information specified in subparagraphs (5) and (6) prior to its participation in a takedown. Information previously submitted in an Issuer Filing or Initial Member Filing may be incorporated into the Subsequent Member Filing and no additional filing fees will be due if the entire fee due under Schedule A to the NASD By-Laws has already been paid in connection with an Issuer Filing or Initial Member Filing;

(iv) “Life of Shelf” Clearance: A member that has received a no-objections opinion in connection with a shelf registered offering shall not be required to make a Subsequent Member Filing in order to participate in future takedowns provided that:

a. the shelf registration statement discloses a maximum amount of underwriting compensation that will not be exceeded by participating members in takedowns; and

b. there is no material change to the information provided in the filing on which NASD relied in issuing the no-objections opinion.

(B) Market Transactions Exemption: a member may participate in a takedown of equity securities or convertible-to-equity debt securities and be exempt from the filing requirement in subparagraphs (4) and (10)(A) above if the following conditions are met:

(i) the shelf offering is not the initial public offering of the issuer's equity securities, and does not occur within 90 days of the issuer's initial public offering;

(ii) the security is listed on The Nasdaq Stock Market or a national securities exchange;

(iii) agency and principal transactions are unsolicited and do not exceed the greater of:

a. 2% of the average daily trading volume (ADTV) on the dates of the transactions, calculated in compliance with SEC Regulation M, or

b. 10,000 shares, or securities convertible or exercisable into such number of shares;

(iv) the participating member has not entered into any underwriting, distribution, equity line or other agreement with the issuer or any selling securityholder with respect to the sale of the securities offered;

(v) the participating member does not receive compensation (including the mark-up, mark-down, or commission) that exceeds the amount permitted under NASD IM-2440, the Mark-Up Policy;

(vi) the participating member has not acquired any item of value in connection with its participation in the shelf offering (excluding a mark-up, mark-down, or commission); and

(vii) the participating member is not an affiliate of the issuer and does not have a conflict of interest with the issuer under Rule 2720.

(C) Seasoned Issuer Exemption: notwithstanding subparagraphs (4) and (10)(A) above, documents and information related to the following shelf offerings need not be filed with NASD for review, unless the shelf offering is subject to the provisions of Rule 2720:

(i) offerings by a company that has been subject to the reporting requirements of Section 12 or 15(d) of the Act for at least 36 calendar months, is current in its reporting obligations, and at the time of the takedown, either:

a. has registered the offering with the Commission on registration statement Form S-3 and the aggregate market value of the company's voting stock held by non-affiliates is at least \$150 million or, alternatively, at least \$100 million and the stock has had an annual trading volume of at least three million shares; or

b. has registered the offering with the Commission on registration statement Form F-3 and the aggregate market value

worldwide of the company's voting stock held by non-affiliates is the equivalent of at least \$300 million;

(ii) offerings registered with the Commission on Form F-10 by a foreign private issuer incorporated or organized under the laws of Canada or any Canadian province or territory and offered pursuant to Canadian reporting requirements for at least 36 calendar months and at the time of the takedown, is current in its reporting obligations and the aggregate market value of the company's outstanding equity is at least (CN) \$360 million.

(10) and (11) renumbered as (11) and (12).

**(c) Underwriting Compensation and Arrangements**

(1) No change.

**(2) Amount of Underwriting Compensation**

(A) through (E) No change.

(F) For purposes of determining the amount of underwriting compensation in a shelf offering, the discount or commission paid to participating members shall be aggregated with all other items of value received or to be received in connection with the takedown and shall consist of:

(i) in a transaction governed by an agreement, the discount from the public offering price, or the discount from a reasonable measure of the market price, or the commission specified by the agreement that governs the transaction;

(ii) in an agency transaction not governed by an agreement, the amount of the actual commission that is received or to be received in connection with the sale of the securities;

(iii) in a principal transaction when the discount from the public offering price is not specified in an agreement or the transaction is not governed by an agreement, the difference between the purchase price of the security and the sale price of the security. If there is a bona fide independent market for the security, or the security is an Actively-Traded Security as defined in Rule 2720 and SEC Regulation M, respectively, the discount or commission may be calculated as the difference between the purchase price and the:

a. "prevailing market price" in the principal market for the security at the time of purchase, as calculated by reference to IM-2440, the Mark-Up Policy; or

b. initial resale price of the security, so long as:

1. the purchase price of the takedown is of at least \$10 million but no more than \$50 million of securities and at least 50% of the securities are sold at the initial resale price or at lower prices; or

2. the purchase price of the takedown exceeds \$50 million of securities and at least 25% of the securities are sold at the initial resale price or at lower prices.

### **(3) Items of Value**

(A) For purposes of determining the amount of underwriting compensation received or to be received by the underwriter and related persons pursuant to subparagraph (c)(2) above, the following items and all other items of value received or to be received by the underwriter and related persons in connection with or related to the distribution of the public offering, as determined pursuant to paragraph (d) below shall be included:

(i) through (iv) No change.

(v) wholesaler's fees[;], whether in the form of cash, securities or any other item of value;

(vi) through (xiii) No Change.

(B) No Change.

**(d) Determination of Whether Items of Value Are Included In Underwriting**

**Compensation**

**(1) Pre-Offering Compensation**

(A) All items of value received and all arrangements entered into for the future receipt of an item of value by the underwriter and related persons during the period commencing 180 days immediately preceding the required filing date of the registration statement or similar document pursuant to subparagraph (b)(4) above until the date of effectiveness or commencement of sales of the public offering will be considered to be underwriting compensation in connection with the public offering. For a shelf offering that has been declared effective and for which sales have commenced, this period will be the 180 days immediately



preceding the first takedown in which the member participates following the receipt of the item of value.

(2) through (5) No change.

**(e) Valuation of Non-Cash Compensation**

For purposes of determining the value to be assigned to securities received as underwriting compensation, the following criteria and procedures shall be applied.

**(1) Limitation on Securities Received Upon Exercise or Conversion of Another Security**

Neither [An] underwriter [and] nor related person may [not] receive a security (including securities in a unit), a warrant for a security, or a security convertible into another security as underwriting compensation in connection with a public offering unless:

(A) through (B) No Change.

(2) through (3) No Change.

**(4) Valuation Discount For Securities With a Longer Resale Restriction**

A lower value equal to 10% of the calculated value shall be assigned [deducted] for each 180-day period that the securities or underlying securities are restricted from sale or other disposition beyond the 180-day period of the lock-up restriction required by subparagraph (g)(1) below. The transfers permitted during the lock-up restriction by subparagraphs (g)(2)(A)(iii)-(iv) are not available for such securities.

**(5) Valuation of Items of Value Acquired in Connection with a Fair Price Derivative or Debt Transaction**

Any debt or derivative transaction acquired or entered into at a “fair price” as defined in subsection (a)(9) and any item of value received in or receivable in the settlement, exercise or other terms of such debt or derivative transaction shall not have a compensation value for purposes of determining underwriting compensation. If the actual price for the debt or derivative security is not a fair price, compensation will be calculated pursuant to this subsection (e) or based on the difference between the fair price and the actual price.

(f) No Change.

**(g) Lock-Up Restriction on Securities**

**(1) Lock-Up Restriction**

In any public equity offering, other than a public equity offering by an issuer that can meet the requirements in subparagraphs (b)[(7)](10)(C)(i) or (ii) any common or preferred stock, options, warrants, and other equity securities of the issuer, including debt securities convertible to or exchangeable for equity securities of the issuer, that are unregistered and acquired by an underwriter and related person(s) during 180 days prior to the required filing date, or acquired after the required filing date of the registration statement and deemed to be underwriting compensation by NASD, and securities excluded from underwriting compensation pursuant to subparagraph (d)(5) above, shall not be sold during the offering, or sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities by any person for a period of 180 days immediately following the date of effectiveness or commencement of sales of the public offering, except as provided in subparagraph (g)(2) below. The “effective date

of the offering” for purposes of a shelf-registered offering shall be the day following the last takedown for which the participating member received securities as compensation.

**(2) Exceptions to Lock-Up Restriction**

Notwithstanding subparagraph (g)(1) above, the following shall not be prohibited:

(A) the [transfer] disposition of any security:

(i) No Change.

(ii) to any member participating in the offering and the officers or partners thereof, if all of the securities [so transferred] remain subject to the lock-up restriction in subparagraph (g)(1) above for the remainder of the time period;

(iii) if the aggregate amount of securities of the issuer held by the underwriter [or] and related person do not exceed 1% of the securities being offered;

(iv) through (viii) No Change.

(B) No Change.

**(h) Proceeds Directed to a Member**

(1) through (2) No Change.

**(3) Exception From Compliance**

The provisions of subparagraphs (h)(1) and (2) shall not apply to:

(A) No Change.

(B) an offering of securities exempt from registration with the Commission under Section 3(a)(4) of the Securities Act [of 1933];

(C) through (D) No Change.

(i) through (j) No change.

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**2810. Direct Participation Programs**

(a) through (b) No change.

**(c) Filing Requirements: Coordination with Rule 2710**

All offerings of securities included within the scope of this Rule shall be subject to the provisions of Rule 2710, and documents and filing fees relating to such offerings shall be filed with NASD pursuant to the provisions of that Rule and Section 6 of Schedule A to the NASD By-Laws.

(c) renumbered as (d).

(d) renumbered as (e).

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**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

**1. Purpose**

NASD is proposing to amend NASD Rules 2710, 2810, IM-2440, and Schedule A to the NASD By-Laws to address the filing requirements and the regulation of public offerings of securities registered

with the Commission and offered by members pursuant to SEC Rule 415 (“shelf offerings”). NASD Rules 2710, 2720 and 2810 (collectively, the “Corporate Financing Rules”) require NASD members that anticipate participating in a public offering of securities, including shelf offerings, to make a filing with NASD’s Corporate Financing Department (“Department”). The Department reviews the proposed underwriting terms and other required information submitted by members.<sup>5</sup> Members are required to receive the Department’s opinion of “no-objections” to the offering terms prior to participating in the offering.

In September 2001, NASD published Notice to Members 01-59 requesting comment on proposed amendments to the Corporate Financing Rules to modernize and improve the regulation of shelf offerings. NASD received six comment letters that generally supported the proposal and the need to amend the rules.<sup>6</sup> However, several commenters also were concerned that the new approach, with its emphasis on “Notice Filings” after each takedown off the shelf, might prove more burdensome and expensive than the current rules. The Corporate Financing Committee also considered the proposal at several meetings. At its May 2002 meeting, the Committee also expressed concern that the Notice Filing approach may not be as efficient and yield the benefits it was designed to provide.

In response to the comments received, NASD staff revised the proposal. In the proposed rule change, NASD has retained beneficial aspects of the original proposal (e.g., the new calculation methodologies for determining underwriting compensation, the Market Transactions Exception), and

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<sup>5</sup> NASD Rule 2710 regulates the underwriting terms and arrangements of most public offerings of securities sold through NASD members. The underwriting terms and arrangements of Direct Participation Program (DPP) offerings are regulated by NASD Rule 2810. NASD Rule 2720 regulates public offerings when the securities offered are those of a member, the member’s parent company, an affiliate of the member, or a company with which a member has a conflict of interest.

<sup>6</sup> Comment letters were received from the Committee on Securities Regulation of the New York State Bar Association, the Capital Markets Committee of the Securities Industry Association, and from the law firms of Fried, Frank, Harris, Shriver & Jacobson, Simpson Thacher & Bartlett, Sullivan and Cromwell, and Shearman and Sterling.

eliminated those other aspects that raised legitimate concerns (e.g., Notice Filings, special filing requirements for Thinly Traded Issuers). In addition, NASD staff modified and clarified the filing requirements.

a. Background

When a member anticipates participating in a shelf offering, the Corporate Financing Rules generally require the member to file the shelf offering with the Department. Many shelf offerings are not underwritten, however, and members have requested guidance in the past concerning their filing obligations in shelf offerings. In 1988, NASD published Notice to Members 88-101 (“NtM 88-101”) to clarify the filing requirements that apply to shelf offerings. The Notice states that the participation of a member in any offering of securities distributed pursuant to SEC Rule 415 constitutes participation in a public offering. The Notice also states that any member who is named as a potential distribution participant in the registration statement or who participates in any transaction that takes securities off the shelf is responsible for ensuring that a timely filing is made with the Department. Notice to Members 01-59 reiterated this position: “Accordingly, NASD Regulation considers shelf offerings to be public offerings within the scope of the Corporate Financing Rules, and members that take securities off a shelf and sell them to the public must file information about the offering with the Department.”

While these Notices indicate that shelf offerings are public offerings that must be filed with the Department, the requirement to file as currently drafted also undermines some of the flexibility intended by the shelf offering process and has created some practical issues and uncertainties for members that sell shelf-registered securities:

- Members have been unclear at times whether the sale by a member of a small amount of shelf-registered securities offered by an issuer or a selling security holder triggers a filing

obligation, and if so, at what point should the member make a filing. Members have questioned whether the execution of unsolicited transactions would constitute “participation in a public offering” for purposes of the Corporate Financing Rules.<sup>7</sup>

- When several members acting independently sell securities, it may be unclear which member must make the requisite filing with the Department.
- Many shelf offerings are initially filed with the SEC by issuers before they enter into underwriting agreements with members. Because the NASD filing requirements are the responsibility of members rather than issuers, few issuers file the offering with the Department. Those issuers that do file with the Department often cannot identify, at the time of filing, the members that will be engaged in sales, nor will they have information regarding underwriting discounts, commissions or other terms and arrangements.<sup>8</sup>
- The Department’s review processes could delay the offering, thus affecting the registrant’s ability to take advantage of market opportunities that shelf registration is designed to provide. This can occur when members do not promptly file shelf-registered offerings when they anticipate they will participate in a takedown, when information required by the rules is not readily available, or due to mistakes in the filing process or transmission of filing fees.

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<sup>7</sup> Rule 2710(b)(4)(A) requires a member that anticipates participating in a public offering of securities subject to the Rule to make a filing with NASD. “Participation in a public offering” is defined in Rule 2710(a)(4) as “...participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis....” Rule 2720 contains a definition of “public offering” that is incorporated by reference in Rule 2710. That definition broadly defines the term as “any primary or secondary distribution of securities made pursuant to a registration statement or offering circular...and all other securities distributions of any kind whatsoever....” NASD does not define the term “distribution” and uses this term in the general sense.

<sup>8</sup> In addition, issuers may file shelf-registered offerings on behalf of selling securityholders, in anticipation of member participation in the sale of the registered securities. Because the timing and amount of securities sold off the shelf will be under the control of the securityholders, the issuer may have little or no information regarding the selling arrangements between the securityholders and members. In response to these uncertainties, NASD’s proposed rule change would provide clear-cut filing responsibilities to all members or exempt them from filing under the proposed market transactions exception.

The proposed rule change addresses these issues by clearly delineating the filing responsibility for members that participate in shelf offerings and providing a streamlined, more automated process for all filers, including issuers. In addition, the proposed rule change provides a specific filing exemption for members that engage in occasional unsolicited takedown transactions, and thus members would not have to file when they participate in shelf takedowns that meet the criteria in the exemption. The proposed rule change is intended to provide clear guidance to members with regard to their filing obligations.

The proposed rule change also addresses the determination of underwriting compensation in shelf offerings. From time to time members have requested guidance on the appropriate calculation of underwriting compensation in shelf takedown transactions. The calculation methodology to apply to a particular takedown transaction can vary because of the many kinds of transactions in which shelf-registered securities are distributed. For example, shelf takedowns can be principal or agency transactions, may be sold to investors at a fixed price or at a discount to the market price, or sold at prevailing market prices. Shelf takedowns may also be made pursuant to an underwriting agreement or without any written agreement, and the agreements may involve complex formulas, such as those found in equity line transactions. In the proposed rule change, NASD proposes alternative methods to calculate the discount or commission received by members that participate in shelf offerings. The alternatives are intended to take into account the different ways members sell securities in shelf offerings and to recognize the effect of transaction size and whether the security has an actively traded market.

The proposed rule change would also make several conforming and clarifying amendments to the Corporate Financing Rules. NASD proposes to amend Rule 2710 to clarify how to apply the review period for underwriting compensation when shelf takedowns occur long



after a shelf registration statement has been declared effective, and to clarify the application of the lock-up provisions in shelf offerings. We also propose to amend Rule 2810 so that DPP offerings that are registered pursuant to SEC Rule 415 qualify for the new regulatory treatment of shelf offerings under Rule 2710. The proposed rule change also modifies NASD's Mark-Up Policy in IM-2440 to more specifically delineate those shelf offerings that are subject to the Policy.<sup>9</sup>

b. Filing Process

Under the proposed rule change, the general filing requirement for shelf offerings would be the same as that for all other public offerings, *i.e.*, a member that anticipates participating in a shelf offering in any capacity shall file required information with the Department, unless a filing exemption is available. Unlike the current system, however, the information required in a filing would differ depending on whether a filing is an “initial filing” or a “subsequent filing” of a shelf offering. Because members would be able to rely on information contained in the initial filing, generally less information will be required in a subsequent filing. In addition, if an issuer makes a filing before the initial filing by a member, the information and documents filed by the issuer (“issuer filing”) would be incorporated into the member’s initial filing, further reducing the filing obligation of the member. In keeping with current practice, if the full filing fee has already been

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<sup>9</sup> The proposed amendments to IM-2440, the Mark-Up Policy, clarify that Rule 2710 will govern member compensation in all shelf takedowns with the exception of those that comply with the requirements of the Market Transactions Exemption (MTE). Members will not be required to file takedowns that comply with the MTE, and member compensation in such takedowns will be subject to the Mark-Up Policy instead of Rule 2710. These clarifications are particularly significant in light of the decision on November 14, 2003 by NASD’s National Adjudicatory Council (NAC) in the Matter of Department of Enforcement v. Walsh Manning Securities, LLC et. al. (NASD Complaint No. CAF000013), in which the NAC stated in *dicta* that certain shelf offerings were not subject to Rule 2710 and were instead subject to the Mark-Up Policy. Although the complaint alleged violations of the Mark-Up Policy, Walsh Manning’s participation in takedowns from a selling securityholder shelf offering would have triggered a filing requirement under the proposed rule change. This is because, among other things, Walsh Manning engaged in solicited transactions and sold securities in an amount that would have exceeded the parameters of the MTE. Therefore, Walsh Manning would have had to file the offering for review under Rule 2710 if the proposed rule change had been in effect at the time.

paid by the issuer, no filing fee would be required of the member making the initial filing. As with other filings made under Rule 2710, members would be required to file shelf offerings with the Department electronically through the COBRADesk system.

**Initial Member Filings:** Under the proposed rule change, before a member participates in a shelf offering subject to a filing requirement, the member would be required to review a COBRADesk screen to see if an initial filing has already been made on web COBRADesk. If the initial filing has not already been made, the member will be required to make the initial filing with the Department and pay the filing fee based on the aggregate value of the securities registered on the registration statement.<sup>10</sup> The Department will review the filing and issue a no-objections letter with regard to the member's participation in the offering. If the maximum amount of compensation that the issuer or selling securityholders will pay the member in connection with takedowns off the shelf is approved and disclosed in the registration statement or in an amendment or supplement to the registration statement, the member will be able to rely on the no-objections opinion for "the life of the shelf," as long as there are no material changes that would affect the Department's review and clearance.<sup>11</sup> If more than one member has entered into an underwriting agreement at the time the initial filing is made, the Department will issue a no-objections opinion that applies to every member disclosed in the initial filing or that executes the underwriting agreements that were reviewed in connection with the filing. If the maximum amount of compensation that any member will receive for selling the securities offered by the

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<sup>10</sup> This is consistent with current procedures. Members from time to time request that they be able to pay filing fees only with regard to the value of securities the particular member takes off the shelf, but that is not permitted under the current rules, and would require members and issuers to pay multiple filing fees per shelf offering, creating administrative problems and delaying takedowns. In addition, if an issuer files documents and information with NASD, the filing fee paid by the issuer would satisfy the member's obligation to pay the filing fee.

<sup>11</sup> Rule 2710 requires the disclosure of all underwriting compensation in the prospectus. As part of its review of a filing, NASD would require the maximum compensation to be received by members be disclosed before issuing an opinion of no-objections regarding the offering.

issuer or selling securityholders in takedowns off the shelf is disclosed in the registration statement or in an amendment or supplement to the registration statement, every member covered by the no-objections opinion will be able to rely on the no-objections opinion for “the life of the shelf,” subject to there being no material change to the terms and conditions of the Department’s review and clearance.<sup>12</sup>

After it issues a no-objections opinion, the Department intends to post on a screen in COBRADesk the name of the issuer, the SEC Accession number of the base prospectus in EDGAR, and the identity of all members who have received no-objections clearance with regard to takedowns off that shelf. NASD intends to require and maintain information identifying each member that will participate in an offering in the COBRA database. All registered users of COBRAdesk will have access to the “cleared members” screen.

**Subsequent Filings:** A member that was not cleared to participate in the initial member filing but that wants to participate in a subsequent takedown would have to make a “subsequent filing.” In that case, a member that wants to participate in a shelf takedown first would check web COBRADesk to see if the offering has been filed with NASD. If the offering has been filed, the member would check the “cleared members” screen to see if an initial member filing has been made. If the initial member filing was made and one or more members were issued a no-objections opinion, these members would be identified. If the member that wants to participate in the takedown is not in the “cleared members” screen, such member would have to make a subsequent filing with regard to its proposed takedown from the shelf registration. If, on the

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<sup>12</sup> For example, NASD would consider changes such as the following to be material: the receipt of additional items of value by the underwriter and related persons that would be deemed underwriting compensation and would require an amendment to the offering documents, a modification to compensation arrangements already reviewed and approved and the existence or development of a potential conflict of interest that was not reviewed. A subsequent filing would be required in these instances.

other hand, the member has already received a “life of shelf” clearance, it would be listed on the “cleared members” screen and no further filing would be required, unless a material change takes place in the future that would require additional review or another subsequent filing. Members are obligated under the Corporate Financing Rules to submit modifications to underwriting compensation or new items of compensation for review after the issuance of a no-objections opinion, and similarly, if a conflict of interest developed, this would be deemed a material change in the terms of the approval. Therefore, “life of shelf” clearance means that if a member remains in compliance with the terms of its clearance then it would not need to file again concerning any takedown from a shelf offering for which the member appears in the “cleared members” screen.

If an initial member filing has been made, but a particular member is not listed on the cleared members screen, then that member would have to make a subsequent filing. No fee would be charged in connection with such a filing, however.<sup>13</sup> The member making the subsequent filing would be required to provide certain summary information and representations through web COBRADesk, and receive a no-objections opinion prior to participating in the offering.

**Expedited Reviews:** In response to comments requesting expedited treatment for shelf offerings, NASD proposes to develop an automated review and clearance (ARC) process for Subsequent Member Filings of shelf offerings that meet eligibility criteria. Although certain offerings, such as those that require a qualified independent underwriter to resolve conflicts of interest, would not be eligible for

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<sup>13</sup> An initial COBRADesk filing cannot be submitted unless the required filing fee is transmitted. Therefore, a fee based on the aggregate amount of securities registered would have already been paid in connection with the initial filing. After the fee for all of the securities registered for sale is paid, no further filing fees would be required. If, however, a subsequent filing includes an amendment that increases the size of the offering or if there is otherwise a balance due, such fees would be required in connection with the subsequent filing.

an automated clearance generated by web COBRADesk, the staff anticipates that ARC would expedite a majority of Subsequent Member Filings. The system generated no-objections letter would be automatic, if all of the required information is provided and there are no review issues such as proposed compensation that exceeds the maximum allowable amount. The system would recognize when a Subsequent Member Filing satisfies these criteria and the member would be displayed in the “cleared member” screen automatically. ARC would permit filers to expedite their own reviews, as the system would issue the no-objections opinion to the members on a 24-hour basis as soon as the requirements for clearance are satisfied. Such approvals would generally be subject to spot checks and the routine member examination process with regard to the veracity of undertakings and information provided to NASD.

c. Market Transactions Exception (MTE)

The MTE was designed to provide an exception from the filing requirements under the Corporate Financing Rules for members that participate in takedown transactions that are more like ordinary trading transactions than public offerings. The original proposal published in 2001 was well received by the commenters and the Committee, although many believed that it was too complex and that it lacked predictability as it exempted some, but not all transactions governed by underwriting agreements. Accordingly, NASD has simplified the MTE by excluding underwritten transactions and deleting some of the volume limitations published in Notice to Members 01-59, and clarified that agency and principal transactions must be unsolicited and may not exceed the greater of 2% of the ADTV for the security (calculated in accordance with SEC Regulation M) or 10,000 shares, on any given trading day.

The requirement that transactions be unsolicited applies to both sides of a securities transaction. For example, in a principal transaction, the member could neither solicit a selling

securityholder to sell shelf-registered securities to it nor solicit a purchaser for such securities. Similarly, in an agency transaction, a member could not solicit an issuer or selling securityholder to sell, nor could it solicit an investor to purchase such securities. The MTE provides an exemption to members that engage in a variety of takedown transactions such as unsolicited brokerage transactions, principal transactions as a result of unsolicited customer orders and transactions in member proprietary accounts, subject to the 2% or 10,000 share daily limit.

Market making transactions in a security for which a member is a registered market maker would generally not constitute participation in a public offering, and NASD would not consider a posted bid or offer by a market maker in the ordinary course of its business to constitute solicitation for purposes of the MTE.<sup>14</sup>

With one exception, the remaining MTE requirements contained in the proposed rule change were published in Notice to Members 01-59, and include the following:<sup>15</sup>

- the shelf offering or takedown cannot be the initial public offering of the issuer's equity securities, and cannot occur within 90 days of the issuer's initial public offering;
- the security must be listed on The Nasdaq Stock Market or a national securities exchange;
- the participating member cannot be an affiliate of the issuer nor have a conflict of interest with the issuer;

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<sup>14</sup> A market maker that engages in solicited transactions involving securities offered by means of a shelf registration statement may have to file. For example, if a market maker engaged in solicited purchases of securities from selling securityholders who were offering their securities pursuant to a prospectus, or that engaged in the solicitation of retail investors to purchase such securities may incur a filing obligation. Market makers that engage in such transactions may in fact be participating in the distribution of a public offering, and may have to comply with the requirements of SEC Regulation M.

<sup>15</sup> In response to comments from SEC staff, NASD has narrowed the MTE to exclude securities quoted on the OTC Bulletin Board. The change was made in recognition that the NASD has a significant regulatory interest in the public distribution of shelf registered securities of thinly traded issuers quoted on the OTC Markets. Securities quoted on the OTCBB are generally less liquid and more volatile than those traded on the national securities exchanges and the Nasdaq Stock Market, and are not subject to the corporate governance and other qualification requirements of those markets.

- the transactions are subject to the 5% limitation under the Mark-Up Policy rather than the compensation limitations under the Corporate Financing Rule;<sup>16</sup> and
- the participating member and its associated persons have not acquired an item of value in connection with their participation in the shelf offering that would be considered underwriting compensation (excluding a discount or commission that complies with the Mark-Up Policy).

Based on these restrictions, members that anticipate selling shelf registered securities in non-underwritten transactions would be required to assess their intended participation level to determine whether the MTE (or other filing exemption) is available or whether an initial or subsequent filing should be made. Under the proposed rule change, a member that only intends to participate in transactions that satisfy the MTE requirements would not be required to make a filing. On the other hand, if a member anticipates that its level of participation would exceed the MTE parameters, the member should make a filing in advance of participation so that it can sell the securities in its accounts or the accounts of its associated persons or affiliates, taking advantage of market conditions without having to monitor compliance with various restrictions in the MTE or be subject to the delay of having to make a filing later. For example, a member should anticipate participating in a shelf offering by selling security holders if a substantial percentage of the securities offered by the selling security holders are held in the member's

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<sup>16</sup> NASD is proposing to amend its Mark-Up Policy, IM-2440, to clarify that shelf takedown transactions that come within the parameters of the MTE will be subject to the Mark-Up Policy, instead of the generally higher compensation limits available under Rule 2710. NASD is also amending the Mark-Up Policy to specifically exclude shelf offerings that are subject to the compensation limits in Rule 2710, so that a takedown transaction by a member will either be subject to IM-2440 because it complies with the MTE, or it will be subject to the compensation limitations of Rule 2710. This is significant in light of the decision by NASD's National Adjudicatory Council (NAC) in Department of Enforcement v. Walsh Manning LLC et al (November, 2003), in which the NAC stated in dicta that certain shelf offerings are not subject to Rule 2710 and affirmed that the takedowns in which Walsh Manning participated were subject to NASD's Mark-Up Policy instead of Rule 2710. Under the proposed rule change, Walsh Manning would have had to make a filing and its compensation would have been subject to Rule 2710, as the takedowns in which the firm participated would not have complied with the requirements of the MTE (see also footnote No. 5).

proprietary or customer accounts, such that it would be likely that proprietary transactions or transactions with its customers or affiliates would exceed 2% of the ADTV for the security on a given trading day.

The proposed rule change would require each member that anticipates participating in a shelf offering takedown to determine whether a filing exemption or the MTE is available, and if not, whether its participation would require an initial filing, subsequent filing, or no filing at all, because the member is already included in the “cleared members” COBRADesk screen for that shelf offering and has “life of shelf” clearance.

d. Underwriting Compensation

Under the proposed rule change, the amount of underwriting compensation in a shelf takedown governed by an underwriting, equity line, private investments in public equity (PIPE), or similar agreement between the issuer and any selling member would generally be based on the commission or discount set forth in the agreement. Such agreements may be firm commitment underwriting agreements, best-efforts underwriting agreements, equity lines of credit agreements, purchase agreements, or some other form of agreement for the sale of securities from a shelf registration. Where there may be some question concerning the appropriate valuation of a discount that is governed by a market-based formula or other more complex compensation arrangement, NASD intends to value the compensation based on its analysis of the arrangement, establishing an appropriate valuation through the review process.

In the absence of an agreement governing a member’s participation in a takedown of securities from a shelf registration, the proposed rule change provides alternative methods of calculation depending on whether a transaction was an agency or principal transaction. In an agency transaction, the underwriting compensation would be the amount of the commission that



is added to the sale price of the securities paid by investors. In a principal transaction where the discount or commission is not specified by an agreement, NASD proposes three methodologies that members could utilize to determine compensation amounts: (1) the Resale Spread Method, in which the discount would be calculated as the difference between the purchase price of the securities off the shelf and their resale price; (2) the Prevailing Market Price Method, in which the discount would be calculated as the difference between the purchase price of the securities off the shelf and the “prevailing market price” of the security at the time of purchase;<sup>17</sup> and (3) the Initial Resale Price Method, in which the discount would be calculated as the difference between the purchase price of the securities off the shelf and the price at which the first significant amount of sales after the takedown were executed. This third methodology would take into account market price movements that occur subsequent to a member’s acquisition of the shelf-registered securities that could affect the discount, while ensuring that enough securities are sold to establish a reasonable, bona fide compensation calculation.

In a principal transaction, NASD anticipates that the Resale Spread method would be the primary method of calculating underwriting compensation, due to the market and transaction size requirements of the other methods. The Resale Price Method would generally be the most accurate measure of compensation regardless of the type of security or manner of distribution. The Prevailing Market Price and Initial Resale Price Methods would be available when members are subject to significant market risk due to the size of a takedown transaction or due to changes

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<sup>17</sup> The prevailing market price would be determined pursuant to IM-2440, the Mark-Up Policy, and Notice to Members 92-16. Because this methodology would not work in a dominated or controlled market, we propose not to make it available for offerings of securities of thinly-traded issuers. The proposed rule change would require that the takedown security be an Actively Traded Security under Regulation M, or a security with a bona fide independent market, as defined in NASD Rule 2720(b) to qualify for the use of the Prevailing Market Price Method.

in market conditions (in an actively traded or bona fide independent<sup>18</sup> market) during the distribution of a shelf takedown. NASD solicits comment on whether the eligibility criteria for these alternative calculation methodologies should be expanded from those currently proposed.

NASD believes that these calculation methodologies will provide greater certainty to members and aid them in complying with the underwriting compensation requirements in connection with their participation in shelf offerings of securities.

## **2. Statutory Basis**

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Specifically, we believe that the proposed rule change amends NASD's Corporate Financing Rule to provide greater clarity regarding when to make filings for shelf offerings while also ensuring that such filing requirements do not undermine the flexibility intended by the shelf registration process.

### **B. Self-Regulatory Organization's Statement on Burden on Competition**

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

### **C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

The proposed rule change was published for comment in NASD Notice to Members 01-59 (September 2001). NASD received six comment letters<sup>19</sup> that generally supported the

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<sup>18</sup> Telephone conversation between NASD and Commission Staff on November 22, 2004.

<sup>19</sup> See note 6, supra.

proposal and the need to amend the rules. However, several commenters also were concerned that the new approach might prove more burdensome and expensive than the current rules. Of the six comment letters received, three were in favor of the proposed rule change and three viewed portions of the proposal unfavorably. NASD notes that the proposed rule change has undergone significant revisions since the publication of Notice to Members 01-59 and the comment letters were sent in response to the original proposal.

In general, the commenters suggested further reductions in members' regulatory burdens and additional exemptions from the filing requirement. NASD does not believe that the more comprehensive exemptions suggested by some commenters, such as exemptions for all Form S-3 filings or all shelf offerings, is warranted. In addition, several commenters apparently misunderstood some aspects of the proposal. We describe the comments received and the way that the proposal was modified in response. We also describe several suggestions made by the commenters that NASD does not support because they would not improve the Corporate Financing Rules or would be inconsistent with their purpose.

**Filing Exemptions for Shelf Offerings:** The proposed rule change eliminates the explicit references to "pre-1992" Form S-3 eligibility requirements in the filing exemption for securities registered on Forms S-3 (and F-3) offered pursuant to SEC Rule 415 while preserving the current filing requirements. This change adds clarity and simplicity as members or their counsel will no longer need to determine what eligibility criteria for those forms were in effect prior to October 1992.

Some commenters requested that NASD reduce the S-3/F-3 exemption requirements to 12 months reporting history and \$75 million in public float, in line with the current eligibility requirements for those forms. NASD believes there are important regulatory purposes for the

current filing requirements and accordingly, we do not propose to expand the S-3/F-3 exemption in response to the comments for the reasons described below:

First, the 12-month reporting and \$75 million float requirements currently in effect are criteria that determine whether an issuer is eligible for a particular type of registration form. The Commission does not exempt the companies that meet these eligibility requirements from filing a registration statement. Accordingly, the argument that NASD should exempt such offerings from filing, and that the Corporate Financing Rule's filing exemption should automatically track a registration form eligibility requirement is not persuasive. Second, SEC Regulation M requires a \$150 million public float as a condition for exemption from trading restrictions during secondary distributions. This requirement supports NASD's position that issuers with less than a \$150 million float are more prone to abusive or fraudulent trading and distribution activity. The SEC adopted SEC Regulation M in 1997, five years after the requirements for Forms S-3/F-3 were relaxed.

Third, in Notice to Members 93-88, the NASD stated that competitive market forces and an active following in the investment community were important factors in its decision to exempt S-3/F-3 shelf offerings.<sup>20</sup> When compared to issuers that are larger and have been reporting companies for a longer period, S-3/F-3 filers with only a 12-month reporting history and a \$75 million float would be less likely to be followed by investment professionals and investors, and would be more likely to have thinly-traded markets for their equity securities. Accordingly, we believe that such companies would be more likely to be subjected to unreasonable underwriting

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<sup>20</sup> NASD is proposing to rescind an interpretation included in Notice to Members 93-88 (December 1993) that stated the filing exemption for S-3/F-3 shelf offerings was not available if the shelf-registered securities were sold in a conventional underwritten offering within a few days following the effective date of the registration statement. This change will liberalize the filing exemption and allow more offerings to be exempt from filing. NASD also proposed to rescind this policy in Notice to Members 01-59 (September 2001).

provisions. NASD has ongoing investigations that involve securities registered on Form S-3.<sup>21</sup> The float and reporting history requirements in the Corporate Financing Rule provide the NASD with an opportunity to review these offerings prior to effectiveness and uncover problems with the compensation structure and other potential violations before members can sell the securities to the public.

One commenter suggests that the provision in Forms S-3 and F-3 that permits a successor entity to tack on the reporting period of a predecessor organization should be incorporated into the Form S-3/F-3 exception in the Corporate Financing Rule. We agree that a successor registrant should be eligible to tack the reporting history of its predecessor in order to meet the 36-month reporting history requirement in the Corporate Financing Rule. The requirements for tacking are narrowly drawn and ensure that the assets, liabilities and public information regarding the successor are equivalent to those of other issuers whose shelf-registered offerings are eligible for the S-3/F-3 exemption.

One commenter recommends that the Rule be amended to provide an additional exemption for offerings by issuers filing on Form F-9.<sup>22</sup> The Department rarely, if ever, receives offerings registered on Form F-9.<sup>23</sup> Form F-9 permits registration of non-convertible debt rated investment grade by an NRSRO or an “Approved Rating Organization.” Due to the fact that there is already an exemption in the Corporate Financing Rule for offerings of securities rated

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<sup>21</sup> These cases involve allegations of undisclosed underwriting compensation, conflicts of interest, failure to file, violations of SEC Regulation M, and other charges. In addition, shelf-registered equity line financings have raised significant issues regarding compliance with NASD Conduct Rules and the federal securities laws.

<sup>22</sup> Large publicly-traded Canadian issuers registering non-convertible investment grade securities may use Form F-9.

<sup>23</sup> Based on the results of a database search, no recent filings on Form F-9 were identified.

investment grade and the lack of filings on Form F-9, we do not find this request for a filing exemption necessary at this time.

**Schedule B Issuers Exemption:** Two commenters recommend that NASD amend the proposal to include an exemption from filing for Schedule B issuers.<sup>24</sup> They state that foreign sovereigns offering debt securities in the U.S. use Schedule B rather than the Forms F-3 or F-10. Currently, there is no exemption from NASD filing requirements for these offerings. We disagree that foreign governments or their political subdivisions that are eligible under SEC rules to use Schedule B are not likely to need NASD review of the underwriting terms and arrangements with U.S. underwriters. NASD believes such an exemption would be inappropriate in light of recent concerns related to inequitable practices of members in such offerings. These recent investigations call into question the assumptions that commenters have made concerning the ability of Schedule B issuers to negotiate on an even footing with global investment banking firms to whom the issuer depends on for advice and funding. Accordingly, NASD has not included such an exemption in the proposed rule change.

**Multi-Issuer (Trust) Exemptions:** One commenter noted an increase in the number of “multi-issuer” shelf offerings by individual corporate groups. The commenter explained that these transactions involve multiple offerings of debt and equity securities by a parent or operating entity and offerings of trust preferred or pass-through securities (“Trust Preferred”) by special purpose vehicles created by the parent or operating entity. The commenter suggested that offerings of Trust Preferred securities should be exempt from filing when the parent or operating

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<sup>24</sup> Schedule B is the Registration Statement used by foreign governments (or political subdivisions of foreign governments) to register securities. If the distribution involves a shelf offering, language appearing on a Schedule B Registration Statement would be similar to the following: “The securities being registered hereby are to be offered on a delayed or continuous basis pursuant to Releases No. 33-6248 and 33-6424 under the Securities Act of 1933.” Therefore, a Schedule B filer is not technically making its shelf offering pursuant to SEC Rule 415, but through other provisions afforded foreign governments.

entity satisfies the criteria for the S-3/F-3 exemption or the exemption for issuers with investment grade rated debt.

NASD does not agree that the proposal should be amended to include an exemption for Trust Preferred securities due to problems recently uncovered in investigations that have involved securities issued from trusts formed as special purpose financing vehicles. The Department generally reviews Trust Preferred securities as DPP offerings under Rule 2810 because of their pass through features. The Department has recently encountered regulatory problems with a variety of DPP offering structures, terms and compensation arrangements, and does not believe it would be appropriate to exempt as a class such offerings from review.

**Expedited Reviews:** Several commenters suggested that the 15-business day review period should be shortened in light of the market timing and competitive environment associated with shelf offerings. In most cases, the Department believes it can complete its review in far fewer than 15 days. The Department is generally attentive to requests for expedited reviews and prioritizes the review of offerings to address the timing concerns of members, and the staff has developed procedures for expedited reviews and would give priority to meeting the timing needs of members that must receive a no-objections letter prior to participating in a shelf offering.

In addition, Subsequent Member Filings of shelf takedowns that meet certain criteria would be eligible for expedited reviews through an automated review and clearance (ARC) process. For certain takedown transactions, such as those that do not require a qualified independent underwriter due to conflicts of interest, members would be eligible for an automatic clearance generated by web COBRADesk for any filings that follow the Initial Member Filing. The system generated no-objections letter would be automatic, if all of the required information is provided and there are no review issues such as proposed compensation that exceeds the maximum allowable amount. The system would

recognize when a Subsequent Member Filing satisfies these criteria and the member would be displayed in the “cleared member” screen automatically. ARC would permit filers to expedite their own reviews, as the system would issue the no-objections opinion to the member(s) on a 24-hour basis as soon as the requirements for clearance are satisfied.

**Notice Filing Requirements:** Notice Filings were proposed in Notice to Members 01-59 (September, 2001) in order to provide members with increased flexibility to quickly take advantage of market opportunities. For certain offerings, members could file after they participated in a takedown and would not need a no-objections opinion prior to such participation in the offering. Many commenters suggested that Notice Filings would not result in the efficiencies envisioned by the staff. Some commenters suggested that Notice Filings would create risks for members as the regulatory review would shift to an examination function as opposed to the pre-effective review and comment process that is currently in effect. Members expressed concern that the filing process and fees did not provide any benefit to members and that members would prefer to manage their regulatory risk in a different manner. Four commenters contend that since the NASD will not render an opinion in connection with these filings, then there would be reason to make a filing, as NASD rules generally do not require members to make filings for the purpose of confirming their compliance with the rules. Commenters also expressed concern that the Notice Filing deadlines within 3 and 10 business days of a takedown could cause confusion. To address these concerns, the staff has eliminated the Notice Filing proposal.

**Coordination of Rule 2710 and Rule 2810:** Two commenters were concerned that the proposal makes offerings subject to Rule 2810 (direct participation programs) subject to the provision of the Corporate Financing Rule. They recommend that the proposed rule change



should not be made without further review of each of the provisions of the Corporate Financing Rule, as it would apply to offerings subject to Rule 2810.

The proposed amendments only apply to the filing requirements of Rule 2810 and conform these requirements and the filing fee requirements with the requirements in the Corporate Financing Rule. The Department would not review DPPs for compliance with the substantive provisions in the Corporate Financing Rule.

**Mark-Up Policy:** One commenter opposed amending IM-2440 since the amendment targets shelf offerings exempt under the Market Transaction Exception. The commenter claims that shelf offerings exempt under MTE are only exempt from the filing requirement of Rule 2710, yet still subject to the compensation limits of Rule 2710 and Rule 2810.

The commenter misunderstands the purpose of the exemption. We do not anticipate that the Market Transaction Exception will apply to most shelf offerings. The exception is designed to be narrow and cover securities sold on an agency basis in an ordinary market transaction that does not rise to the level of a “distribution.” Because such trades are not distributions, the generally higher compensation limits available under the Corporate Financing Rule for members engaged in a distribution would not be available. Instead, the transaction would be governed by the NASD’s Mark-Up Policy.

**The Acquisition of Unregistered Securities and Rule 144A:** Two commenters state that, in their experience, securities acquired by members and their associated persons from issuers before a shelf offering are not compensatory and do not represent an opportunity to provide underwriting compensation to NASD members for a subsequent offering. The commenters state that members and their affiliates frequently hold securities of issuers sold in Rule 144A offerings, which may have been acquired as an unsold allotment by a dealer acting as

an initial purchaser, from other dealers acting as initial purchasers, or from third parties in the private secondary resale market. These commenters claim that if a member purchased securities of the issuer's securities pursuant to Rule 144A, the member could not underwrite a shelf tranche within 180-days of the takedown, as the acquisitions would make the member ineligible for a Notice Filing. One commenter notes that this may have a negative effect upon issuers because they may be prohibited from using the investment bankers with whom they are most familiar and would create an unlevel playing field among members and reduce competitive choices for issuers.

NASD staff notes that these comments were generated as a result of the Notice Filing proposal, which was eliminated. Under the proposed rule change, members that anticipate participation in a shelf offering, subject to available filing exemptions and the Market Transactions Exception, will make either an initial or a subsequent filing. Unregistered securities that constitute items of value that were acquired by such members, or their affiliates and associated persons within 180 days of the filing would be reviewed by NASD and would only be deemed underwriting compensation if appropriate, and subjected to the applicable compensation limitations and disclosure requirements of the Corporate Financing Rules.

**Selected Dealers:** One commenter suggested that compensation to selected dealers is not relevant to underwriting compensation. Another commenter wrote that selected dealers are not underwriters for purposes of the Securities Act.<sup>25</sup> These commenters claim that selected dealers should be excepted from the information required by the NASD concerning participating members, and unregistered securities and items of value received by selected dealers should not

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<sup>25</sup> Section 2(a)(11) of the Securities Act provide that the term underwriter “shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission.”

be included in the calculation of underwriting compensation. They also claim that selected dealers should not have an obligation to make filings under the Corporate Financing Rule.<sup>26</sup>

The basic premise for including selected dealers' compensation as underwriting compensation is that such members are participating in the distribution of an offering. The definition of "participation in a public offering" in the Corporate Financing Rules, includes participating on "...an underwritten, non-underwritten, or any other basis..." and therefore includes selected dealers. Moreover, the rule specifically requires that selected dealer agreements be filed for review. The staff has reviewed offerings in which a selected dealer was allocated a substantial portion of the underwritten securities due to its relationship with the issuer and the managing underwriter. NASD Notice to Members 88-101 states that the "participation of a member in any offering of securities distributed pursuant to Rule 415 constitutes participation in a public offering." Excluding selected dealers would create loopholes in the treatment of underwriting compensation and conflicts of interest. NASD views selected dealers as members participating in public offerings.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

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<sup>26</sup> Selected Dealers are typically covered by the filing made by a managing underwriter.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-022 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File No. SR-NASD-2004-022. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying

at the principal office of NASD. All submissions should refer to file number SR-NASD-2004-022 and should be submitted by [insert date 45 days from the date of publication].<sup>27</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>27</sup> NASD has consented to an extension of time for the Commission to take action on this proposed rule change.

<sup>28</sup> 17 CFR 200.30-3(a)(12).