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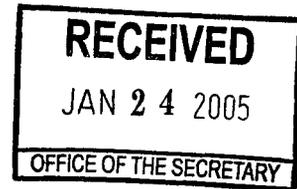
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January 21, 2005

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Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609



Re: File No. SR-NASD-2004-022  
Securities and Exchange Commission Release No. 34-50749:  
Proposed Rule Change Relating to Shelf Offerings of Securities  
under the Corporate Financing Rules of the National Association  
of Securities Dealers, Inc.

Dear Mr. Katz:

The Bond Market Association (the "Association")<sup>1</sup> welcomes the opportunity to comment on the above-referenced proposal (the "Proposal"). The Proposal has been made by the National Association of Securities Dealers, Inc. (the "NASD") in an attempt to streamline the process of filing and review of certain documentation relating to public offerings of securities registered with the Securities and Exchange Commission (the "SEC") and offered by NASD members pursuant to Rule 415 of Regulation C under the Securities Act of 1933 (the "1933 Act") on a Registration Statement on Form S-3 (for domestic issuers; the "Form S-3") or a Registration Statement on Form F-3 (for foreign issuers; the "Form F-3" and, together with the Form S-3, "Shelf Registration Statements"). Although the Association agrees with the goal of streamlining this process, it is the view of the Association, as discussed below, that the Proposal contains several elements which detract from this goal and should be remedied prior to the SEC's approval of the Proposal.

**I. The Proposal Should Eliminate Any Filing Requirement For Offerings of Investment-Grade Securities.**

The members of the Association are concerned, generally, about the applicability of the filing requirements of NASD Rules 2710 and 2720 (the "Corporate Financing Rules") to offerings of investment-grade rated, non-convertible debt securities pursuant to a Shelf Registration Statement ("Investment-Grade Public Offerings").

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<sup>1</sup> The Association represents securities firms and banks that underwrite, distribute and trade fixed-income securities and other credit market instruments in the United States and globally. Additional information about the Association and its members and activities is located at [www.bondmarkets.com](http://www.bondmarkets.com).



Investment-Grade Public Offerings are generally exempt from the filing requirements of NASD Rule 2710 by reason of one or more of the following: (i) the exemption set forth in subsection (b)(7)(A) relating to "securities offered by a corporate, foreign government or foreign government agency issuer which has unsecured non-convertible debt with a term of issue of at least four (4) years, or unsecured non-convertible preferred securities, rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories",<sup>2</sup> (ii) the exemption set forth in subsection (b)(7)(B) relating to "non-convertible debt securities and non-convertible preferred securities rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories", and (iii) the exemption set forth in subsection (b)(7)(C) in connection with certain offerings conducted through Shelf Registration Statements.<sup>3</sup> In addition to Investment-Grade Public Offerings, members of the Association also engage in public offerings of investment grade-rated asset-backed securities ("ABSs"), including mortgage-backed securities, through Shelf Registration Statements or on a non-shelf basis, but such offerings separately qualify for the exemption from the filing requirements of NASD Rule 2710 set forth in subsection (b)(7)(E) thereunder relating to "financing instrument-backed securities which are rated by a nationally recognized statistical rating organization in one of its four (4) highest generic rating categories."

Even though an exemption pursuant to subsection (b)(7) of NASD Rule 2710 may be available to a particular offering, a filing, among other things, is nonetheless required under NASD Rule 2720 where an NASD member participating in the offering is an "affiliate" of the issuer, the issuer is a member of the NASD, or the issuer is a "parent" of a member of the NASD.<sup>4</sup> Pursuant to NASD Rule 2720(m), the

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<sup>2</sup> Such exemption does not apply to the initial public offering of the equity securities of the issuer in question.

<sup>3</sup> Subsection (b)(7)(C) exempts offerings of securities (i) registered with the SEC on Shelf Registration Statements pursuant to the standards for those forms prior to October 21, 1992 and offered pursuant to Rule 415 under the 1933 Act, that were in effect; or (ii) issued by a person incorporated or organized under the laws of Canada or any Canadian province or territory, and which is registered with the SEC on Form F-10 pursuant to the standards for that form approved in 1933 Act Release No. 6902 (June 21, 1991) and offered pursuant to Canadian shelf prospectus offering procedures.

<sup>4</sup> See NASD Rule 2720(a). Pursuant to NASD Rule 2720(b)(1), the term "affiliate" is defined to generally mean "a company which controls, is controlled by or is under common control with a member." Pursuant to NASD Rule 2720(b)(10), the term "parent" is defined to mean "any entity affiliated with a member from which member the entity derives 50 percent or more of its gross revenues or in which it employs 50 percent or more of its assets."



requisite filing, including the filing fee, in respect of an offering subject to NASD Rule 2720 is the same as for offerings subject to NASD Rule 2710, except that the exemptions set forth in NASD Rule 2710(b)(7) are not available.

In addition, NASD Rule 2720, including the filing requirement thereunder, is applicable to any offering in which an NASD member participating in the offering has a "conflict of interest" with the issuer.<sup>5</sup> Public offerings of investment-grade rated ABSs, however, are not subject to the filing and other requirements of NASD Rule 2720 by reason of specific exceptions therefor from the definitions of "affiliate" and "conflict of interest."<sup>6</sup>

If an Investment-Grade Public Offering is subject to the filing and other requirements of NASD Rule 2720, the offering must generally be priced in accordance with NASD Rule 2720(c)(3), which generally requires that the offering be priced by a "qualified independent underwriter" (a "QIU").<sup>7</sup> Pursuant to NASD Rule 2720(c)(3)(C), however, an Investment-Grade Public Offering is not required to be priced by a QIU because the offering involves "a class of securities rated Baa or better by Moody's rating service or BBB or better by Standard & Poor's rating service, or such securities are rated in a comparable category by another rating service acceptable to the NASD." Such exception is based on the grounds that notwithstanding the existence of an affiliation or conflict of interest between the issuer and the NASD member/underwriter, the pricing of the securities will be determined primarily on the basis of the rating assigned to the securities by an independent credit rating agency and macroeconomic forces affecting

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<sup>5</sup> Pursuant to NASD Rule 2720(b)(7), the term "conflict of interest" generally means where an NASD member, any associated person thereof, a parent of the NASD member, or any affiliate of the NASD member beneficially owns, in the aggregate, at least 10% of the common equity, preferred equity, or subordinated debt securities of the issuer.

<sup>6</sup> See NASD Rule 2720(b)(1)(C)(v) and (b)(7)(D)(vi), respectively.

<sup>7</sup> Pursuant to NASD Rule 2720(b)(15), the term "qualified independent underwriter" generally means an underwriter which is not affiliated with the issuer and which does not have a conflict of interest with the issuer, and which underwriter has sufficient experience in managing or co-managing Investment-Grade Public Offerings. In addition to the requirement that a QIU generally price the securities, NASD Rule 2720 imposes certain other requirements as well. For example, pursuant to NASD Rule 2720(l), if the securities are being issued by an NASD member or an affiliate of a member, or by an issuer with which a member has a conflict of interest, no NASD member may execute any transaction involving the securities being offered in a discretionary account without the prior specific written approval of the customer.



interest rates, thereby diffusing the influence that such NASD member/underwriter might be able to exert, by reason of such affiliation or conflict of interest with the issuer, in connection with the pricing of the offering.<sup>8</sup>

Thus, as a general matter, Investment-Grade Public Offerings are exempt from the filing requirements of NASD Rule 2710, unless an NASD member participating in the offering is an affiliate of the issuer or has a conflict of interest with the issuer. In the case of an affiliation or conflict of interest, although the offering may be subject to the filing and other requirements of NASD Rule 2720, the offering need not be priced by a QIU, by reason of the exception therefrom set forth in NASD Rule 2720(c)(3)(C) for investment grade-rated securities, on the grounds that the investment-grade rating assigned by an independent rating agency diffuses the influence that the NASD member/underwriter may have by reason of being an affiliate of the issuer or having a conflict of interest therewith. In addition, because, as noted above, the NASD has acknowledged that debt securities are priced primarily on the basis of interest rate movements rather than demand factors, the influence of any participating NASD member on the pricing of the offering, whether or not such member has an affiliation or conflict of interest with the issuer, is minimized.

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<sup>8</sup> See, for example, SEC Release No. 34-40001, 63 F.R. 28535 (May 18, 1998) under "Part II.C. – Exceptions to the Public Offering Exemption Definition." Although this release relates to an amendment to the definition of "public offering" in the NASD's former "Free-Riding and Withholding" interpretation or "hot issue" rule (which interpretation has since been replaced by NASD Rule 2790 relating to "Restrictions on the Purchase and Sale of Initial Equity Public Offerings"), the rationale appears to be equally applicable to the NASD's Corporate Financing Rules: the NASD specifically amended the definition of "public offering" in its Free-Riding and Withholding interpretation in 1998 in order to exclude non-convertible debt securities which are rated investment grade on the grounds that "such offerings do not raise the same issues as equity offerings inasmuch as the price for a particular debt security generally fluctuates based on interest rate movements rather than demand factors." This rationale – that the price of debt securities are dependent on interest rate movements – has broader implication and does not appear to be conditioned upon the availability of an investment grade rating, but would appear to apply generally to debt securities whether or not rated investment grade. The NASD subsequently extended the aforesaid exception to the definition of "public offering" to investment grade-rated convertible debt securities that were convertible into "actively-traded" common or preferred equity. See interpretive letter issued by Gary L. Goldsholle dated December 21, 1998 entitled "Application of Free-Riding and Withholding Interpretation to Investment Grade Debt Convertible into Actively Traded Securities."



As noted above, the filing requirement for offerings subject to NASD Rule 2720 is merely the filing that would otherwise be required under NASD Rule 2710. Yet, in the case of Investment-Grade Public Offerings, the NASD has conceded that the type of information that would be required to be submitted in connection with a filing under NASD Rule 2710 is of little utility – that is why the NASD created the various exemptions from such filing requirement set forth in NASD Rule 2710(b)(7), as described above, that are applicable to such offerings. And, the requirement to price the offering by a QIU – the driving force underlying NASD Rule 2720 – is not even required in the case of offerings involving investment-grade rated debt securities, such as Investment-Grade Public Offerings. Although NASD Rule 2720 imposes certain other requirements that are not dependent upon the rating of the securities being offering, such as the prohibition against effecting sales in discretionary accounts or ensuring that the issuer establishes an audit committee or elects a public director to serve on the audit committee (which are already requirements for issuers which have securities listed on the Nasdaq National Market or the New York Stock Exchange), the submission of information relating to such other requirements is not part the specific information requirements under NASD Rule 2710, as set forth in NASD Rule 2710(b)(6).

Moreover, the primary focus of the NASD's review of offerings subject to filing under NASD Rule 2710 relates to the amount of underwriting compensation and the fairness of the underwriting terms and arrangements. However, underwriting discounts that are typically charged in Investment-Grade Public Offerings are often less than 1% - far below those charged in public equity offerings. In addition, because of the established and deep market for Investment-Grade Public Offerings and the requirements imposed by independent credit rating agencies, there should be little concern that the underwriting terms and arrangements in respect of any such offering will not comport with accepted market standards. Rather, the presence of the various exemptions from filing set forth in NASD Rule 2710(b)(7) and well as the focus of the compensation provisions of NASD Rule 2710(c), (d) and (e) establish a clear orientation of NASD Rule 2710 towards public equity offering, not Investment-Grade Public Offerings.<sup>9</sup> As such, there would not appear to be any compelling policy

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<sup>9</sup> See, for example, NASD Rule 2710(c)(3)(A) which enumerates various "items of value" for the purposes of the determination of the amount of underwriting compensation being paid to NASD members in connection with an offering: subsection (c)(3)(iv) and (v) relate to finder's fees and wholesaler's fees, respectively; subsection (c)(3)(vi) relates to financial consulting and advisory fees; subsection (c)(3)(vii) relates to the underwriters' receipt of common or preferred equity, options, warrants, and other equity securities, including debt securities convertible to or exchangeable for equity securities; subsection (c)(3)(viii) and NASD Rule 2710(i) relate to special sales incentive items and payments of noncash compensation; subsection (c)(3)(x) relates to compensation



justification to subject an offering of investment-grade rated debt securities, or Investment-Grade Public Offerings, to the filing requirements of NASD Rule 2710 in the case where an NASD member/underwriter has an affiliation or conflict of interest with the issuer.<sup>10</sup>

Accordingly, the Association respectfully submits that there are no compelling justifications for requiring the filing of a Shelf Registration Statement for review by the NASD under the NASD's Corporate Financing Rules in connection with an offering of investment grade-rated debt securities for which there is an affiliation or conflict of interest pursuant to NASD Rule 2720. Thus, the Association recommends

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to be received by the underwriter and related persons or by any person nominated by the underwriter as an advisor to the issuer's board of directors in excess of that received by other members of the board of directors; and subsection (c)(3)(xi) relates to commissions, expense reimbursements, or other compensation to be received by the underwriter and related persons as a result of the exercise or conversion, within twelve months following the effective date of the offering of warrants, options, convertible securities, or similar securities distributed as part of the public offering. These items are, and have historically been, associated with offerings of equity securities, not debt securities, let alone offerings by issuers of investment grade-rated debt securities. NASD Rule 2710(d)(5) establishes various "exceptions" from underwriting compensation which are clearly oriented to equity offerings. See also NASD Rule 2710(e) relating to the valuation of noncash compensation which, again, is focused on noncash items of value that would be received in connection with an equity offering, not a debt offering and especially not an offering by an issuer of investment grade-rated debt securities. Finally, see NASD Rule 2710(g)(1) which imposes a lock-up on the transfer or sale of securities received by an underwriter or related person. Although the subsection (g)(1) is, by its terms, limited to public equity offerings, we do believe that this suggests that NASD Rule 2710 is equally oriented to debt offerings in view of, among other things, the other provisions cited above.

<sup>10</sup> See also, SEC Release No. 34-17488, 46 F.R. 11077 (Feb. 5, 1981) wherein the NASD proposed to lower the requisite ratings, in what is now Rule 2720(c)(3)(C), to "Ba" by Moody's or "BB" by Standard and Poor's (from "Baa" and "BBB", respectively) in order to avoid having to price the offering by a QIU. As justification for such proposal, the NASD "concluded that the pricing mechanism of the marketplace can now be expected to properly evaluate offerings of this type." Although such proposal was subsequently withdrawn by the NASD (see SEC Release No. 34-19689, 48 F.R. 17667 (Apr. 25, 1983)), there was no public indication that the NASD had changed its conclusion as to the influence of the independent market factors in the pricing of debt offerings.



that the NASD amend the Proposal to exempt such offerings from the filing requirements under NASD Rules 2710 and 2720.

**II. The Proposal Is Not Consistent With Market Timing Requirements Regarding Shelf Takedowns.**

**(i) Current "Requirements":<sup>11</sup>**

If an NASD member is named as an underwriter for an offering in the applicable base prospectus which is filed as part of the Shelf Registration Statement, and provided that there is disclosed in the "Underwriting" section of the applicable base prospectus that the maximum compensation payable to the NASD members upon any "takedown" will not exceed 8% of the aggregate offering amount thereof, the NASD will issue a "no objections" letter covering all potential takedowns from the Shelf Registration Statement and covering all future underwriters.<sup>12</sup>

If an underwriter is not named in the base prospectus which is filed as part of the Shelf Registration Statement, the NASD will issue a no-objections letter that also covers all potential takedowns from the Shelf Registration Statement, but that is conditioned upon the subsequent filing with the NASD of (i) all amendments or supplements to the Shelf Registration Statement, (ii) a list of distribution participants in connection with the particular takedown, along with the information as to items of value acquired by such participants and their affiliates during the 180-day period preceding the date of the applicable prospectus supplement, and (iii) any modifications to the underwriting terms and arrangements that were previously filed with the NASD in connection with such Shelf Registration Statement.

In each case, however, once the no-objections letter is issued by the NASD, no further clearance is required prior to any takedown from the applicable Shelf Registration Statement, unless there is a material change in the underwriting terms and arrangements that would make reliance on the no-objections letter inappropriate.

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<sup>11</sup> These are not formal requirements set forth in NASD Rule 2710, but rather are procedures which have been incorporated by the NASD into the COBRADesk system, which is the internet-based system by which all filings with the NASD Corporate Financing Department are perfected.

<sup>12</sup> The no-objections letter will deemed to cover future takedowns from the Shelf Registration Statement, provided that in connection with any particular takedown there are no "material" changes to the information previously filed with the NASD.



Thus, under the current requirements, takedowns can occur without any pre-clearance by the NASD whether or not members intending to participate in the offering were previously disclosed to the NASD. Regardless of whether the initial filing is perfected by the underwriter or by the issuer, the no-objections letter is good for the "life" of the shelf, subject to the limitations described above. Provided that a no-objections letter has been issued in respect of the Shelf Registration Statement and there are no material changes in the terms of the underwriting arrangements, there is no need for the underwriters to delay the commencement of the offering and their selling efforts with respect to any particular takedown from the applicable Shelf Registration Statement in order to obtain a subsequent approval from the NASD.

The absence of any further approval by the NASD in connection with takedowns from Shelf Registration Statements is critically important to the smooth operations of the capital markets. Shelf takedowns often take place with very little, or no, advance notice to the underwriters. In order to take advantage of favorable market conditions, shelf takedowns can often occur on the same day that such takedown is proposed. Even a relatively short delay in the commencement of an announced offering as a result of NASD members being forced to wait for further clearance by the NASD with respect to a takedown could subject the offering to rapidly changing market conditions that might result in less favorable (and more costly) terms for the issuer or which might cause the issuer to abandon the offering all together and, thus, in effect, vitiate the SEC's policies underlying the adoption of Rule 415 under the 1933 Act.<sup>13</sup> Although the Proposal attempts to address these timing issues by distinguishing between "Initial Member Filings" and "Subsequent Member Filings", the Proposal nonetheless does not adequately account for the speed with which takedowns occur and, thus, would likely impede efficient capital formation.

**(ii) Proposed Requirements:**

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<sup>13</sup> In noting the benefits of the shelf registration system, the SEC has noted the cost savings and flexibility involved in shelf issuances: "Commentators stress that flexibility is important in today's volatile markets; that the procedural flexibility afforded by [Rule 415] enables a registrant to time its offering to avail itself of the most advantageous market conditions; that by being able to meet 'market windows,' registrants are able to obtain lower interest rates on debt and lower dividend rates on preferred stock, thereby benefiting their existing shareholders. The flexibility provided by [Rule 415] also permits variation in the structure and terms of securities on short notice, enabling registrants to match securities with the current demands of the marketplace. Some commentators attributed the success of their offerings to the flexibility provided by [Rule 415]. Empirical studies also support the importance of enhanced financing flexibility in new issue design, market timing and choice of distribution technique." See SEC Release 33-6499, 83-84 CCH Dec., FSLR ¶83,449 (Nov. 17, 1983).



Pursuant to proposed NASD Rule 2710(b)(4)(A)(iii) and (b)(4)(B)(ii), before any single NASD member can sell securities in any takedown from a Shelf Registration Statement, there must be provided by the NASD a no-objections letter "that covers the member."

Pursuant to proposed NASD Rule 2710(b)(10)(A)(iii), if an NASD member will be acting as an underwriter in respect of a takedown from a Shelf Registration Statement and such member has not previously been identified to the NASD as an underwriter therefor, the NASD member will be required to submit a "Subsequent Member Filing" to the NASD and will not be permitted to participate in the underwriting until such member receives a no objections letter. Although the Proposal would establish an automated review and clearance ("ARC") system which would permit the NASD to electronically issue "no objections" letters within 24 hours after the filing therewith of a "Subsequent Member Filing", a 24-hour turn-around is still too long, in the view of the Association, under potentially rapidly changing market conditions, and is inconsistent with the objectives of Rule 415, as discussed above. In any event, the expedited review process through the ARC system will not be available in connection with a takedown which must be priced by a QIU.

Accordingly, the Association strongly recommends that the NASD maintain the current procedure of the NASD whereby it issues a "conditional" no-objections letter in connection with the initial filing of a Shelf Registration Statement, but does not impose any further requirement to obtain NASD clearance prior to any takedown.

### **III. Inconsistency Between the Lead-In Language of Subsection (b)(4)(A) and Proposed Subsection (b)(4)(A)(iii).**

There appears to be an inconsistency between the lead-in language of subsection (b)(4)(A) and proposed subsection (b)(4)(A)(iii). The lead-in to subsection (b)(4)(A) requires that a filing be made with the NASD when a member anticipates "participating" in a public offering,<sup>14</sup> whereas proposed subsection (b)(4)(A)(iii) would require that a Shelf Registration Statement be filed before the NASD member "sells any securities" in any takedown. Because the term "participating" appears to include much more than just selling securities in an offering, a member could be participating in a public offering for these purposes at a point substantially before it actually commences

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<sup>14</sup> NASD Rule 2710(a)(5) defines the term "participation" or "participating in a public offering" to mean "participation in the preparation of the offering or other documents, participation in the distribution of the offering on an underwritten, non-underwritten, or any other basis, furnishing of customer and/or broker lists for solicitation, or participation in any advisory or consulting capacity to the issuer related to the offering."



any sales of securities therein. We believe that the term "participation" or "participating in a public offering" is unnecessarily overbroad and results in uncertainty as to the precise moment when a filing is required. Accordingly, the Association believes that the better formulation is to trigger a filing when an NASD member sells the securities, as is proposed under subsection (b)(4)(A)(iii).

#### **IV. Life of the Shelf Standard.**

Proposed Rule 2710(b)(10)(A)(iv)(b) states that a member which has received a no-objections letter in connection with a Shelf Registration Statement will not be required to make an additional filing to participate in future takedowns provided "there is no material change to the information provided in the filing on which the NASD relied in issuing the no-objections opinion." Although, as noted above, the NASD imposes a "materiality" requirement under its current filing requirements, such requirement is merely reflective of the NASD's informal policy and is not memorialized into the Corporate Financing Rules and, thus, is presumably open to fair and reasonable interpretation by members. Proposed subsection (b)(10)(A)(iv)(b), on the other hand, not only requires that there not be any "material" change to the information provided in a filing, but also that the information is not that "on which NASD relied in issuing the no-objections opinion." The problem is the inherent subjectivity in determining whether the NASD "relied" on any particular information filed therewith in connection with the issuance of a no objections letter as well as to what the NASD would deemed to be "material" for these purposes. At the very least, proposed subsection (b)(10)(A)(iv)(b) could expose members to a specific violation of NASD Rule 2710 as a result of unannounced changes in the subjective interpretations of the persons who review filings under the Corporate Financing Rules. Accordingly, we would recommend that NASD Rule 2710(b)(10)(A)(iv)(b) be amended to state that "there is no material change to the information provided in the filing."

#### **V. Implication for Well-Known Seasoned Issuers.**

The Proposal does not account for the SEC's proposals relating to the 1933 Act regarding Securities Offering Reform.<sup>15</sup> Specifically, the SEC has proposed "automatic shelf registration" for any "well-known seasoned issuer" (a "WKSI").<sup>16</sup> As

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<sup>15</sup> See SEC Release No. 33-8501, 69 F.R. 67392 (Nov. 3, 2004) (the "Securities Offering Reform Proposal").

<sup>16</sup> WKSI's must be current for the past 12 months in filing their periodic reports with the SEC under the Securities Exchange Act of 1934 (the "Exchange Act"), must be eligible to use Form S-3 or F-3, and must have a public common equity float of at least \$700 million. For debt offerings, an issuer could also qualify as a WKSI through a debt-based test by issuing at least \$1 billion in SEC-registered debt securities within the last three years.



such, offerings by WKSIs would feature automatic effectiveness upon filing with the SEC; that is, there will not be any need to wait for SEC staff review of the offering before sales of securities could be made. The SEC has proposed automatic shelf registration for WKSIs on the grounds that such issuers have a substantial reporting history under the Exchange Act and are broadly scrutinized by investors and the markets.<sup>17</sup> Although many offerings by WKSIs would qualify for an exemption from filing under NASD Rule 2710 (subject to the discussion herein regarding the interplay of the exemptions in subsection (b)(7) and proposed subsection (b)(10)), offerings where an NASD member has an affiliation or conflict of interest with the WKSI would not be exempt from filing by reason of the application of NASD Rule 2720 thereto.

In light of the NASD's proposed requirement, described above, to require that each NASD member participating in, or selling securities under, a takedown from a Shelf Registration Statement receive a no-objections letter specifically covering such member prior to the commencement of such member's participation or selling efforts, the SEC's proposals in the Securities Offering Reform Proposal relating to WKSIs, described above, would be completely vitiated. Accordingly, the Association would propose adding provisions to NASD Rule 2710 to provide for a self-executing exemption from the filing requirements thereunder for any Shelf Registration Statement of a WKSI, even if the offering involved an affiliation or conflict of interest under NASD Rule 2720.

#### **VI. Interplay of Exemptions in Subsection (b)(7) and Proposed Subsection (b)(10).**

As noted above, NASD Rule 2710(b)(7) provides several exemptions that are available to offerings conducted under a Shelf Registration Statement. Proposed subsection (b)(10)(A) generally imposes a filing required for offerings made pursuant to a Shelf Registration Statement.<sup>18</sup> Proposed subsections (b)(10)(B) and (C) provide specific exemptions for (i) takedowns involving seasoned issuers that are more like ordinary trading transactions than public offerings<sup>19</sup> and (ii) takedowns from Shelf Registration Statements in respect of issuers who meet certain enumerated standards

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<sup>17</sup> See Section II.A of the Securities Offering Reform Proposal under the heading "Well-Known Seasoned Issuers."

<sup>18</sup> Specifically, the lead-in language to proposed subsection (b)(10)(A) states that "a member that is required to file with NASD documents and information required in subparagraphs (5) and (6) shall make" one of the requisite filings set forth in proposed subsection (b)(10)(A)(i), (ii), or (iii).

<sup>19</sup> See proposed NASD Rule 2710(c)(10)(C).



(that used to be required by the SEC in order for an issuer to be eligible to use SEC Form S-3 or SEC Form F-3 prior to October 21, 1992, respectively).<sup>20</sup>

The lead-in language to proposed subsection (b)(10)(C), however, states that "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." Because neither the general filing requirement set forth in proposed subsection (b)(10)(A) for Shelf Registration Statements nor the specific exemptions set forth in proposed subsection (b)(10) reference the exemptions set forth in NASD Rule 2710(b)(7), it would appear that the Proposal inadvertently eliminates the availability of the subsection (b)(7) exemptions for Shelf Registration Statements so that the only exemptions from filing available with respect to Shelf Registration Statements would be the specific exemptions set forth in proposed subsection (b)(10).

In contrast to the exemption set forth in NASD Rule 2710(b)(7)(C)(i), which provides an exemption from filing if the issuer in question meets the standards for Form S-3 or Form F-3 that existed prior to October 21, 1992, but does not otherwise specifically enumerate, or list, those standards, the exemption set forth in proposed subsection (b)(10)(C) actually enumerates the Form S-3 and Form F-3 standards which were in effect prior to October 21, 1992. As a result, the exemption set forth in proposed subsection (b)(10)(C) would not be available to financing subsidiaries of Form S-3 eligible issuers. Pursuant to Section I.C. of the General Instructions to the Form S-3, as they existed prior to October 21, 1992, certain majority-owned subsidiaries were eligible to register securities on Form S-3, even if the subsidiary itself did not meet the public reporting and public float requirements of such form, provided that the subsidiary's ultimate parent company met such public reporting and public float requirements. However, under proposed subsection (b)(10)(C), a financing subsidiary would not be exempt from the filing requirements of subsection (b)(10)(C) because the subsidiary, itself, would not be able to meet the public reporting and public float requirements set forth therein, although this is important only if the financing subsidiary cannot meet one of the investment-grade exemptions pursuant to NASD Rule 2710(b)(7) (subject to the discussion above regarding the availability of such exemptions to Shelf Registration Statements under the Proposal).<sup>21</sup> Finally, it does not

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<sup>20</sup> Pursuant to the Proposal, the current "shelf registration" exemption set forth in NASD Rule 2710(b)(7)(C) would be deleted.

<sup>21</sup> Various issuers that meet the applicable public reporting and public float requirements for Form S-3 or Form F-3, as they existed prior to October 21, 1992, typically create wholly-owned financing subsidiaries that meet the requirements of Section 3(a)(5) of the Investment Company Act of 1940 in order to avoid registration thereunder.



appear to serve any purpose to require, for example, a wholly-owned finance subsidiary of a public parent to perfect a filing under NASD Rule 2710 when the public parent could effect the offering, directly, without having to perfect such filing and then could infuse the proceeds therefrom into the finance subsidiary.

Notwithstanding the foregoing, however, the Association believes that the better approach for an exemption tailored to offerings conducted under Shelf Registration Statements is one that is consistent with the SEC's current standards for Forms S-3 and Form F-3, not historical standards that date over 12 years ago. We do not believe that the NASD has provided any evidence to justify why the SEC's current Shelf Registration Statement requirements are not sufficient to establish the shelf exemption as opposed to the pre-October 21, 1992 standards for such forms. And, as discussed above, such historical distinction becomes more important in light of the SEC's proposed automatic shelf registration for WKSIs.

**VII. Proposed Amendment to the Definition of "Underwriter or Related Person" Creates an Ambiguity in Rule 2710.**

The NASD proposes to amend the definition of "underwriter and related persons" in subsection (a)(6) to include "any other persons that receive any item of value that would be considered underwriting compensation". However, the determination of whether items of value are included in underwriting compensation set forth in subsection (d)(1) states that 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 180 days immediately preceding the required filing date of the registration statement until the date of effectiveness or commencement of sales will be considered underwriting compensation in connection with the public offering. This creates a circular logic where one is required to look at the definition of "item of value" to determine if a person is an "underwriter or related person" but one must look to the definition of "underwriter or related person" to determine if something is an "item of value".

Whereas the current rule provides clarity in this area with a bright line test (i.e. anything received by an underwriter or a person related to the underwriter, among other clearly identified persons, within 180 days of the NASD filing is an item of value), the proposed revisions would create an ambiguity in the rule which the NASD sought to eliminate when the rule was amended in March 2004. The Association does not believe the NASD has articulated a reason for the change in the definition which justifies a departure from the clarity which the rest of the rule seeks.



### VIII. Determination of Whether or Not Items of Value Are Considered to be Underwriting Compensation Lacks Consistency.

As noted above, subsection (d)(1) of Rule 2710 contains the test for determining whether or not an "item of value" will be deemed to be "underwriting compensation" for the purposes of the rule. Rule 2710(d)(1)(A) currently states "[a]ll 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 ... 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. " The NASD proposes to amend this provision by adding the following sentence: "[f]or a shelf offering that has been declared effective and for which sales have commenced, this period will be for the 180 days immediately preceding the first takedown in which the member participates following the receipt of the item of value." (underlining supplied).

If a Shelf Registration Statement has been declared effective, but no takedowns have taken place to date, the proposed amendment to subsection (d)(1) would appear to require that the relevant 180-day period would still be the 180 days prior to the filing date of the Shelf Registration Statement with the SEC, which could be well over 180 days prior to the first takedown thereunder. The Association believes that to require NASD members to look back beyond the 180-day period preceding the date of the prospectus supplement in order to determine if they have received compensation from the issuer merely because they are participating in the first takedown from the Shelf Registration Statement imposes an unnecessary burden on such underwriters and extends, potentially for an indeterminate period of time, the "look back" period for the determination of pre-offering compensation. As was stated by the SEC in approving the 180-day "look back" in the most recent amendments to Rule 2710, "a bright-line test should provide greater clarity and predictability concerning application of the Rule to specific transactions. Consequently, members and their venture capital and lending affiliates should find it easier to determine at the time of a private placement or other financing whether their investment will be treated as underwriting compensation when the subsequent public offering is filed with the Department for review. The [SEC] also believes that shortening the time-frame from one year to six months is reasonable and reflects the NASD's experience that a longer time frame has generally been unnecessary to minimize the opportunity for abusive practices by members."<sup>22</sup>

Accordingly, the Association proposes that the appended sentence should be amended to remove the words "and for which sales have commenced."

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<sup>22</sup> SEC Release No. 34-48989, 68 F.R. 75684 (Dec. 31, 2003).



**IX. An Exemption Should Be Added for "Shelf Offerings" of Sovereign Debt on Schedule B**

Schedule B is the registration statement used by foreign governments (or political subdivisions of foreign governments) to register securities. Because these offerings are made on a Schedule B and not on a Form F-3, such offerings are not eligible for the shelf registration exemption under NASD Rule 2710(b)(7)(C) or under proposed subsection (b)(10)(C)(i), even though the foreign issuer in question may have been active in the U.S. capital markets and is widely followed in the U.S. marketplace. In contrast, securities issued or guaranteed by the U.S. and/or its instrumentalities are exempt from the filing and other requirements of the Corporate Financing Rules by reason of being "exempt securities", as defined in Section 3(a)(12) of the Exchange Act.<sup>23</sup>

Although the NASD has, in connection with the Proposal, asserted that "an exemption [for offerings by Schedule B issuers from having to be filed under the Corporate Financing Rules] would be inappropriate in light of recent concerns related to inequitable practices of members in such offerings" and that "recent investigations call into question the assumptions that commentators 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",<sup>24</sup> the NASD has failed to establish that such concerns are not merely isolated occurrences that are not representative of Schedule B offerings in general. To the contrary, the Association is not aware of any problems that suggest that Schedule B offerings are any more problematic than offerings which are otherwise eligible for exemptions from filing under the Corporate Financing Rules. Accordingly, the Association proposes the adoption of an exemption for Schedule B offerings from filing under the Corporate Financing Rules.

**X. Conclusion**

The Association supports and commends the efforts of the NASD in attempting to streamline the filing and review process for shelf registration offerings. However, we are of the view that the Proposal can be significantly improved in order to achieve this goal.

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<sup>23</sup> See NASD Rule 2710(b)(8)(B).

<sup>24</sup> SEC Release No. 34-50749, 69 F.R. 70735 (Dec. 7, 2004).

Mr. Jonathan G. Katz  
January 21, 2005  
Page 16



We thank you for the opportunity to comment on the Proposal. Please do not hesitate to contact the undersigned at 646-637-9220 with any questions or for additional information.

Very truly yours,

*Michele C. David /c*

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Vice President  
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cc: ***Securities and Exchange Commission***

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