



NASAA

September 23, 2002

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, D.C. 20006-1500

Re: NASD Notice to Members 02-55

Dear Ms. Sweeney:

Please accept this comment letter from the North American Securities Administrators Association, Inc. ("NASAA") in response to NASD Notice to Members 02-55 concerning the Regulation of IPO Allocations and Distributions (proposed new NASD Rule 2712 and amendment to NASD Rule 2710).

The proposal would expressly prohibit the following types of conduct:

- The allocation of IPO shares as consideration or inducement for the payment of excessive compensation for other services provided by the member;
- The solicitation of aftermarket orders for the allocation of IPO shares;
- The allocation of IPO shares to an executive officer or director of a company on the condition that the officer or director send the company's investment banking business to the member, or as consideration for investment banking services previously rendered; and
- The imposition of a penalty on registered representatives whose retail customers have "flipped" IPO shares when similar penalties have not been imposed with respect to syndicate members.

Generally, NASAA agrees with these prohibitions, but we also note that these kinds of conduct are already prohibited and unlawful as fraud under both the state and federal securities laws. NASAA believes that the mechanisms for prosecuting such violations are already in place. We note further that your association has recently brought enforcement actions against its members for engaging in these types of conduct. However, we do not object if the purpose of the proposal is an attempt by the NASD to

remind its members of their preexisting obligations to deal with the public in a manner which is fair, just and equitable.

Taking each of these subjects in turn, NASAA makes the comments below.

I. Prohibition of the allocation of IPO shares as consideration or inducement for the payment of excessive compensation for other services provided by the member

NASAA's reaction to this provision is that it is already prohibited conduct. Currently, it is a violation of the law for a broker-dealer or individuals associated with the broker-dealer to demand or induce excessive compensation in exchange for an allocation of IPO shares. Clearly, such behavior is inconsistent with a fair and open market for investors. As a representative of state securities regulators who protect individual investors, NASAA finds it inconceivable that such favoritism is tolerated in the securities industry.

NASAA questions the paragraph in the Notice to Members under this section that states, "NASD does not intend that this prohibition interfere with legitimate customer relationships. For example, the prohibition is not intended to prohibit a member from allocating IPO shares to a customer because the customer has separately retained the member for other services, when the customer has not paid excessive compensation in relation to those services." "Excessive compensation" is not defined in the proposal and it appears that this paragraph creates an exception that undermines the clarity of the rule.

II. Prohibition of the solicitation of aftermarket orders for the allocation of IPO shares

According to the Notice to Members, the SEC Division of Market Regulation has already made a pronouncement in its Staff Legal Bulletin No. 10 (August, 2000), that this type of conduct is fraudulent and manipulative. The proposal quotes the SEC Bulletin, "solicitations and tie-in agreements for aftermarket purchases are manipulative because they undermine the integrity of the market as an independent pricing mechanism." We agree that this is also a violation of the law under the current state and federal securities laws.

III. Prohibition of the allocation of IPO shares to an executive officer or director of a company on the condition that the officer or director send the company's investment banking business to the member, or as consideration for investment banking services previously rendered

Simply put, we think this kind of conduct is a form of corporate bribery to allocate IPO shares to an executive officer or director of a company, in exchange for investment banking business or in consideration for investment banking business already rendered. We believe that this conduct is already unlawful under the state and federal securities laws.

NASAA also believes that allowing the practice of allocating supposedly unallocated shares to another individual after the IPO has taken place, at the IPO price, with the stock trading on the open market, is an especially sinister practice. Once a stock is trading in the marketplace, any sale or reallocation of shares should be made at the market price rather than the IPO price. Doing otherwise provides gross favoritism in favor of insiders over investors in the marketplace. This is inconsistent with a fair and open market with equal access for all participants.

IV. Prohibition against the imposition of a penalty on registered representatives whose retail customers have “flipped” IPO shares when similar penalties have not been imposed with respect to syndicate members

NASAA understands that this rule would prohibit the other members of the underwriting syndicate from exacting a penalty from their agents, if the managing underwriter had no rule in place to penalize its own agents for such conduct. We believe that penalty bids should be applied or not without regard to whether the agent’s customer is an institutional or retail client.

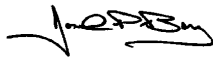
V. Requirements for Procedures

NASAA believes that the NASD member firms already have the obligation to put procedures in place to prohibit violations of the state and federal securities laws.

VI. Conclusion

NASAA appreciates the opportunity to comment on this proposal. We would recommend that the NASD continue its efforts to make substantive changes in this area.

Very truly yours,

A handwritten signature in black ink, appearing to read "Joseph P. Borg".

Joseph P. Borg
President