

keep its MBS Division open. Accordingly, the proposed rule change should enable DTC to eliminate unproductive expenditures and use its resources in a more efficient manner to promote the prompt and accurate clearance and settlement of securities transactions.

The concern raised in the State Street letter regarding dealer time concerns an industry practice relating to the settlement of Fedwire-eligible securities and is not the subject of this proposed rule change.¹⁰ Furthermore, the Fed addressed this issue in a 1995 release adopting new closing times for the Fedwire securities transfer system.¹¹ Responding to State Street's suggestion that the Fed also review the need for a dealer turnaround deadline, the Fed stated that "[d]ealer-turnaround time was established by the PSA [the previous name of the BMA] as an industry guideline to promote the smooth functioning of the government securities market" and that "[t]he dealer-turnaround deadline had been reflected in the Federal Reserve Banks' operating circulars; however, the Reserve Banks do not police participant activity with respect to this time." The Fed concluded that their action (*i.e.*, adopting new closing times) did "not preclude the continuation of an industry standard for a dealer-turnaround time if the industry believes it is needed." Therefore, because GNMA securities will now be cleared and settled through the Fedwire system, commenters should direct their concerns regarding Fedwire rules to the Fed.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-DTC-2001-14) be, and hereby is, approved.

¹⁰ The first State Street letter acknowledged this by recognizing "that disapproval of the DTC rule proposal * * * might not necessarily prevent the transfer of GNMA securities to the Fedwire system or compel the abolition of dealer time." Goelzer letter (Dec. 14, 2000) at page 7, fn 10.

¹¹ 60 FR 42410 (Aug. 15, 1995).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-17679 Filed 7-12-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46165; File No. SR-NASD-2002-87]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to Establishing Effective Dates for NASD Rule 2711, Research Analysts and Research Reports

July 3, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 1, 2002, the National Association of Securities Dealers, Inc. ("NASD") submitted to the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. On July 3, 2002, the NASD filed Amendment No. 1 to the proposed rules change.³ The NASD has designated the proposed rule change as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule series under paragraph (f)(1) of Rule 19b-4 under the Act,⁴ which renders the proposal effective upon filing Amendment No. 1 with the Commission. The Commission is

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, NASD established a further condition for delaying the implementation of Rules 2711(b) and (c) until November 6, 2002 for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions. Amendment No. 1 requires that those firms that meet the eligibility requirements outlined above must maintain records of communications that would otherwise be subject to the gatekeeper provisions of Rules 2711(b) and (c). In Amendment No. 1, NASD also corrected several technical errors that appeared in its original filing. See letter from Marc Menchel, Senior Vice President and General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated July 2, 2002 ("Amendment No. 1").

⁴ 17 CFR 240.19b-4(f)(1).

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

Pursuant to the provisions of Section 19(b)(1) of the Act,⁵ the NASD is filing with the Commission a proposed rule change to establish November 6, 2002 as the effective date for certain provisions of NASD Rule 2711. First, the proposed rule change would establish November 6, 2002 as the effective date for Rules 2711(b) and (c) for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions. Rules 2711(b) and (c), when effective, will prohibit a research analyst from being subject to the supervision or control of any employee of a member's investment banking department, and will further require legal or compliance personnel to intermediate certain communications between the research department and either the investment banking department or the company that is the subject of a research report or recommendation ("subject company").

Second, the proposed rule change would also establish November 6, 2002 as the effective date for Rule 2711(h)(2) as applied to the receipt of compensation by a member's foreign affiliates from a subject company. Rule 2711(h)(2), when effective, will require a member to disclose in research reports all compensation received by it or its affiliates from a subject company for investment banking services in the past 12 months, or expected to be received in the next 3 months.⁶

Third, the proposed rule change would establish November 6, 2002, subject to certain conditions, as the effective date for Rule 2711(g)(3) for those research analysts who must divest holdings to comply with their firm's more restrictive policy that prohibits analyst ownership of securities they cover. Rule 2711(g)(3), when effective, will prohibit a "research analyst account" from purchasing or selling a security or option or derivative of that security, in a manner contrary to the analyst's most recent published recommendation reflected in the member's research report.

⁵ 15 U.S.C. 78s(b)(1).

⁶ See Amendment No. 1, *supra* note 3.

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

In its original rule filing with the Commission, the 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. The 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

The NASD is filing the proposed rule change to establish November 6, 2002 as the effective date for the following provisions of NASD Rule 2711: (a) Rules 2711(b) and (c) for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions; (b) Rule 2711(h)(2) as applied to the receipt of compensation by a member's foreign affiliates from a subject company; and (c) Rule 2711(g)(3), subject to certain conditions, for those research analysts who must divest certain holdings to comply with their firm's more restrictive policy that prohibits analyst ownership of securities they cover.

On May 10, 2002, the Commission approved new NASD Rule 2711, which governs conflicts of interest when research analysts recommend equity securities in research reports and during public appearances.⁷ The Commission approved a staggered implementation period for the rule. Most provisions of the rule become effective on July 9, 2002, including those that restrict supervision and control of research analysts by the investment banking department and those that require disclosure of investment banking compensation received from a subject company. The "gatekeeper" provisions, described below, become effective September 9, 2002, and Rule 2711(h)(1)(B)—a requirement to disclose firm ownership of subject company

securities—becomes effective on November 6, 2002.

Small Firms and "Gatekeeper" Provisions

Rule 2711 contains provisions that generally restrict the relationship between the research and investment banking departments, including "gatekeeper" provisions that require a legal or compliance person to intermediate certain communications between the research and investment banking departments. Rule 2711(b)(1) prohibits a research analyst from being under the control or supervision of any employee of the investment banking department. Rule 2711(b)(2) prohibits employees in the investment banking department from reviewing or approving any research reports prior to publication. Rule 2711(b)(3) creates an exception to (b)(2) to allow investment banking personnel to review a research report prior to publication to verify the factual information contained therein and to screen for potential conflicts of interest. Any permissible written communications must be made through an authorized legal or compliance official or copied to such official. Oral communications must be made through, or in the presence of, an authorized legal or compliance official and must be documented.

Similarly, Rule 2711(c) restricts communications between a member and the subject company of a research report, except that a member may submit sections of the research report to the company to verify factual accuracy and may notify the subject company of a ratings change after the "close of trading" on the business day preceding the announcement of the ratings change. Submissions to the subject company may not include the research summary, the rating or the price target, and a complete draft of the report must be provided beforehand to legal or compliance personnel. Finally, any change to a rating or price target after review by the subject company must first receive written authorization from legal or compliance.

As the Commission noted in its May 10th order, several commenters argued that the gatekeeper provisions would impose significant costs, especially for smaller firms that would have to hire additional personnel. Commenters also noted that personnel often wear multiple hats in smaller firms, thereby causing a greater burden to comply with the restriction on supervision and control by investment banking personnel over research analysts. These comments raised the prospect that the rules might force some firms out of

business and/or reduce the research coverage of smaller companies.

The NASD is sensitive to the burdens on small firms and, as the Commission's May 10th order noted, is reviewing the issue to explore possible exemptions or accommodations that can be made while preserving the purposes of the rule. To that end, the NASD is proposing to delay implementation of Rules 2711(b) and (c) until November 6, 2002 for members that over the previous three years, on average, have participated in 10 or fewer investment banking transactions on underwritings as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions.

As a further condition for the delayed implementation date, those firms that meet the eligibility requirements outlined above would be required to maintain records of communications that would otherwise be subject to the gatekeeper provisions of Rules 2711(b) and (c). The NASD believes that for these members, provided they comply with the conditions described, the burdens of the specific provisions outweigh the benefits to the investing public. Moreover, relief from these provisions will preserve these firms' roles as sources for capital and research for smaller local and regional issuers.⁸

Receipt of Investment Banking Compensation by Foreign Affiliates

Rule 2711(h)(2)(A)(ii) requires a member to disclose in research reports if the member or its affiliates: (a) Managed or co-managed a public offering of the subject company's securities in the past 12 months; (b) received compensation for investment banking services from the subject company in the past 12 months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months. The NASD understands that members are setting up systems that can readily track the information required by this provision of the rule. However, certain members, particularly those with global operations and several foreign affiliates, have informed the NASD that the scope of their operations make it impossible to have systems in place by July 9, 2002, to track all investment banking compensation received by their foreign affiliates. For example, one firm has informed the NASD that it generates over 300 global research products per day and that each of its foreign divisions are separately automated. According to

⁷ See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) ("May 10th order").

⁸ See Amendment No. 1, *supra* note 3.

this firm, mapping revenues from one division to another would require manual matching of identification numbers. The firm has undertaken to do so with respect to its United States-based affiliates, but has told the NASD it requires more time to aggregate compensation from all of its foreign affiliates. The NASD further understands that other members with global operations have similar challenges.

The NASD recognizes that the tracking of investment banking compensation received from foreign affiliates requires significant resources and therefore believes it is appropriate to allow members additional time to set up systems to enable compliance with the rule. Accordingly, the NASD is proposing to delay the implementation date for Rule 2711(h)(2)(A)(ii) until November 6, 2002, only as it relates to investment banking compensation received by members' foreign affiliates. Members would remain responsible for complying with the rule's provisions for investment banking compensation received by the member and those affiliates based in the United States. Members who delay implementation would have to disclose that their foreign affiliates may (a) have managed or co-managed a public offering of the subject company's securities in the past 12 months; (b) have received compensation for investment banking services from the subject company in the past 12 months; or (c) expect to receive or intend to seek compensation for investment banking services from the subject company in the next 3 months. Members that delay implementation of Rule 2711(h)(2)(A)(ii) must notify NASD's Corporate Financing Department in writing at 9509 Key West Avenue, Rockville, MD 20850.

Trading Against Recommendations

Rule 2711 contains provisions that restrict personal trading by research analysts, but it does not completely prohibit ownership of securities that the analyst covers. One such restriction is found in Rule 2711(g)(3), which becomes effective on July 9, 2002. That provision prohibits a "research analyst account" from purchasing or selling a security or option or derivative of that security, in a manner contrary to the analyst's most recent published recommendation reflected in the member's research report. The rule defines "research analyst account" as any account in which a research analyst or member of the research analyst's household has a financial interest, or over which the analyst has discretion or control, except for an investment

company registered under the Investment Company Act of 1940.

Several members have gone beyond the requirements of the rule and instituted internal policies that prohibit research analysts from owning securities that they cover. Most of these firms require that analysts divest themselves, over a certain period of time, of any existing holdings in securities they cover. Consequently, analysts could face the predicament of violating Rule 2711(g)(3) to comply with their firm's more restrictive policy because they could be required by their firm to divest their holdings in a security even as they maintained a buy recommendation in that security. Absent some relief from the rule, analysts would have to divest all holdings in securities they cover by July 9, 2002, or cease coverage in those securities in which they held positions.

To alleviate the described dilemma, and to allow an orderly liquidation of holdings, the NASD is proposing to delay implementation of Rule 2711(g)(3) until November 6, 2002, only for analysts that meet the following conditions: (a) They are employed by a member firm that, as of July 9, 2002, has adopted a policy that bans analyst ownership of securities they cover and further requires complete divestiture of existing holdings in those securities; (b) they abide by a reasonable plan of liquidation under which all shares are to be sold by November 6, 2002 and file that plan with their firm's legal or compliance department no later than July 9, 2002; (c) they receive written approval of the liquidation plan from their firm's legal or compliance department; and (d) they notify NASD's Corporate Financing Department of their delayed implementation of the provision in writing at 9509 Key West Avenue, Rockville, MD 20850.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,⁹ which requires, among other things, that the 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. The NASD believes that this proposed rule change would reduce or expose conflicts of interest and thereby significantly curtail the potential for fraudulent and manipulative acts. The NASD further believes that the proposed rule change will provide investors with better and more reliable information

with which to make investment decisions.

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

The 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

Written comments were neither solicited nor received.

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

The proposed rule change has been filed by the NASD as a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule under Rule 19b-4(f)(1) under the Act.¹⁰ Consequently, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 the NASD. All submissions should refer to the file

⁹ 15 U.S.C. 78o-3 (b)(6).

¹⁰ 17 CFR 240.19b-4(f)(1).

number SR-NASD-2002-87 and should be submitted by August 5, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46168; File No. SR-NASD-2002-65]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 by the National Association of Securities Dealers, Inc. to Amend Schedule A to the NASD By-Laws Relating to Transaction Fees

July 8, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 21, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. On June 26, 2002, the NASD amended the proposal.³ The NASD again amended the proposal on June 27, 2002.⁴ The Association filed the proposal pursuant to Section 19(b)(3)(A) of the Act,⁵ and Rule 19b-4(f)(2) thereunder⁶ as one establishing or changing a due, fee, or other charge, which renders the proposed rule change effective upon filing with the

Commission. 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

The NASD proposes to amend Section 8(b) of Schedule A to the NASD By-Laws to conform Schedule A to Section 31 of the Act,⁷ as amended by H.R. 1088, the Investor and Capital Markets Fee Relief Act ("Fee Relief Act"). The text of the proposed rule change is below. Proposed additions are in italics; proposed deletions are in brackets.

BY-LAWS OF NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Schedule A

* * * * *

Section 8—Transaction Fees

* * * * *

(b) SEC transaction fee. Each member shall be assessed an SEC transaction fee. *The amount of the transaction fee shall be determined by the SEC in accordance with Section 31 of the Act.* [of 1/300 of one percent of the aggregate dollar value of sales of covered securities transacted by or through such member. For purposes of this section, covered securities shall mean:

- (i) all securities traded otherwise than on a national securities exchange (other than bonds, debentures, other evidences on indebtedness, and any sale or any class of sales of securities which the Securities and Exchange Commission may exempt from the fee imposed by Section 31 of the Act, and securities described in subparagraph (ii)) that are subject to prompt last sale reporting and (ii) effective October 1, 1997, securities registered on a national securities exchange pursuant to Section 12(b) of the Act (other than bonds, debentures, other evidences of indebtedness, and any sale or any class of sales of securities which the Securities and Exchange Commission may exempt from the fee imposed by Section 31 of the Act) traded otherwise than on such exchange.]

* * * * *

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

In its filing with the Commission, the 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. The Association 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

Section 31 of the Act provides for the assessment of transaction fees ("Section 31 fees") to be paid to the Commission. Section 31 levies transaction fees for exchange and off-exchange traded securities. Schedule A, Section 8(b) of the NASD By-Laws provides that these fees are assessed at a rate equal to 1/300 of one percent of the aggregate amount of sales transacted by or through any member of a national securities association or transacted on a national securities exchange (other than bonds, debentures, and other evidences of indebtedness and securities futures products). Under Schedule A, Section 8(b), the NASD collects the fee for off-exchange traded securities from members on behalf of the Commission.

On December 21, 2001, Congress passed the Fee Relief Act, which provides for the reduction of Section 31 fees. Specifically, the Fee Relief Act amends Section 31 to reduce the transaction fees collected from 1/300 of one percent to \$15 per \$1,000,000. This rate went into effect on December 28, 2001.

The Fee Relief Act also provides for an annual adjustment of the fee rate and, in some circumstances, a mid-year adjustment. The SEC will calculate the adjustments in accordance with the Fee Relief Act and publish the revised rates well in advance of any adjustment.

The proposed amendment to Schedule A to the NASD By-Laws conforms the NASD By-Laws to these Congressional changes and allows for future adjustments to be made to the rates as specified by the SEC and in Section 31 of the Act.

2. Statutory Basis

The NASD believes the proposed rule change is consistent with Section 15A(b)(5) of the Act,⁸ which requires, among other things, that a national securities association's rules must provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See June 26, 2002 letter from T. Grant Callery, NASD, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), SEC, and attachments ("Amendment No. 1"). In Amendment No. 1, the NASD amended the statutory basis for the proposed rule change to reflect its belief that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act. 15 U.S.C. 78o-3(b)(5).

⁴ See June 27, 2002 letter from T. Grant Callery, NASD, to Katherine England, Assistant Director, Division, SEC ("Amendment No. 2"). In Amendment No. 2, the NASD provided new proposed rule language to correct a technical problem with the proposed rule language previously provided. For purposes of calculating the 60-day abrogation period, the Commission considers the period to have begun on June 27, 2002, the date that the NASD filed Amendment No. 2.

⁵ 15 U.S.C. 78s(b)(3)(A).

⁶ 17 CFR 240.19b-4(f)(2).

⁷ 15 U.S.C. 78ee.

⁸ 15 U.S.C. 78o-3(b)(5).