

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47110; File No. SR-NYSE-2002-49; SR-NASD-2002-154]

### Self-Regulatory Organizations: Notice of Filing of Proposed Rule Changes by the New York Stock Exchange, Inc. (Relating to Exchange Rules 344 (“Supervisory Analysts”), 345A (“Continuing Education for Registered Persons”), 351 (“Reporting Requirements”) and 472 (“Communications With the Public”) and by the National Association of Securities Dealers, Inc. Relating to Research Analyst Conflicts of Interest

December 31, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 9, 2002, the New York Stock Exchange, Inc. (“NYSE” or the “Exchange”), and on October 25, 2002, National Association of Securities Dealers (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule changes as described in Items I, II, and III below, which Items have been prepared by the respective self-regulatory organizations (“SROs”). On December 4, 2002, NYSE submitted Amendment No. 1 to its proposed rule change.<sup>3</sup> On December 18, 2002, NASD submitted Amendment No. 1 to its proposed rule change.<sup>4</sup>

The Commission is publishing this notice to solicit comments on the

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

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

<sup>3</sup> See Letter from Darla Stuckey, Corporate Secretary, New York Stock Exchange, Inc., to James A. Brigagliano, Assistant Director, Division of Market Regulation (“Division”), Commission (December 4, 2002) (“NYSE Amendment No. 1”). NYSE Amendment No. 1 conformed aspects of the proposed NYSE rules to those of NASD (See SR-NASD-2002-154), and proposed effective dates for the various rule provisions.

<sup>4</sup> See Letter from Philip Shaikun, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission (December 18, 2002) (“NASD Amendment No. 1”). NASD Amendment No. 1 inserted language in proposed Rule 1050 to clarify that only research analysts who are directly responsible for the preparation of research reports (as opposed to indirect supervisors or others who are not directly responsible) would be required to register with NASD and pass a qualification examination. NASD Amendment No. 1 also conformed NASD’s proposed research analyst compensation provisions to comparable provisions in the NYSE’s research analyst rule amendments. NASD Amendment No. 1 also amended the definition of “research report” to conform it to the requirements of the Sarbanes-Oxley Act of 2002. NASD Amendment No. 1 also revised certain language that was contained in the discussion of the proposed amendment concerning print media interviews and articles.

proposed rule changes from interested persons.

#### I. Self-Regulatory Organizations’ Statement of the Terms of Substance of the Proposed Rule Changes

The SROs propose to amend their rules to address research analyst conflicts of interest. NYSE filed with the Commission proposed amendments to Rule 472 (“Communications with the Public”). The proposed amendments expand upon recently approved amendments to Rule 472<sup>5</sup> and will place further restrictions on associated persons’ (hereinafter referred to as research analysts) preparing research reports, compensation and trading activities, as well as additional disclosure requirements on research reports issued by members and member organizations.

Proposed amendments to Rule 351 (“Reporting Requirements”), will require members and member organizations to document the basis and approval of a research analyst’s compensation as required by Rule 472(h)(2) and include it in the annual written attestation that they are required to submit to the Exchange.

Proposed amendments to Rule 344 (“Supervisory Analysts”), will require a new registration category and qualification examination for research analysts. Proposed amendments to Rule 345A (“Continuing Education for Registered Persons”), will include research analysts and supervisory analysts as covered persons subject to the Firm Element of the Continuing Education Program to address applicable rules, regulations, ethics and professional responsibility.

NASD filed with the Commission proposed amendments to NASD Rules 1120 and 2711, and a proposed rule change to create a new NASD Rule 1050, to expand upon recently approved rules that govern research analyst conflicts of interest.

Below is the text of the proposed rule changes. Proposed new language is in *italics*; proposed deletions are in [brackets].

#### A. NYSE’s Proposed Rule Text

##### Rule 472 Communications With the Public

##### Approval of Communications and Research Reports

(a)(1) Each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available

<sup>5</sup> See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002).

by a member or member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designated under the provisions of Rule 342(b)(1).

(2) Research reports must be [prepared or] approved, in advance, by a supervisory analyst acceptable to the Exchange under the provisions of Rule 344. Where a supervisory analyst does not have technical expertise in a particular product area, the basic analysis contained in such report may be co-approved by a product specialist designated by the organization. In the event that the member organization has no principal or employee qualified with the Exchange to approve such material, it must be approved by a qualified supervisory analyst in another member organization by arrangement between the two member organizations.

#### Investment Banking, Research Department and Subject Company Relationships and Communications

(b)(1) Research Department personnel or any associated person(s) engaged in the preparation of research reports may not be subject to the supervision or control of the Investment Banking Department of the member or member organization. Research reports may not be subject to review or approval prior to distribution by the Investment Banking Department.

(2) Investment Banking personnel may check research reports prior to distribution only to verify the accuracy of information and to identify or to review for any potential conflicts of interest that may exist, provided that:

(i) Any such written communication concerning the accuracy of research reports between the Investment Banking and Research Departments must be made either through the Legal or Compliance Department or in a transmission copied to Legal or Compliance; and

(ii) Any such oral communication concerning the accuracy of research reports between the Investment Banking and Research Departments must be documented and made either with Legal or Compliance personnel acting as intermediary or in a conversation conducted in the presence of Legal or Compliance personnel.

(3) A member or member organization may not submit a research report to the subject company prior to distribution, except for the review of sections of a draft of the research report solely to verify facts. Members and member organizations may not, under any circumstances, provide the subject company sections of research reports

that include the research summary, the research rating or the price target.

(i) Prior to submitting any sections of the research report to the subject company, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.

(ii) If after submission to the subject company, the Research Department intends to change the proposed rating or price target, the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

(iii) The member or member organization may not notify a subject company that a rating will be changed until after the close of trading in the principal market of the subject company one business day prior to the announcement of the change.

(4) *No associated person may issue a research report or make a public appearance concerning a subject company if the associated person engaged in any communication with the subject company in furtherance of obtaining investment banking business prior to the time the subject company entered into a letter of intent or other written agreement with the member or member organization designating the member or member organization as an underwriter of an initial public offering by the subject company. This provision shall not apply to any due diligence communication between the associated person and the subject company, the sole purpose of which was to analyze the financial condition and business operations of the subject company.*

#### Written Procedures

(c) Each member and member organization must establish written procedures reasonably designed to ensure that members, member organizations and their associated persons are in compliance with this Rule (see Rule 351(f) and Rule 472(h)(2) for attestations to the Exchange regarding compliance).

#### Retention of Communications

(d) Communications with the public prepared or issued by a member or member organization must be retained in accordance with Rule 440 ("Books and Records"). The names of the persons who prepared and who reviewed and approved the material must be ascertainable from the retained records and the records retained must

be readily available to the Exchange, upon request.

#### Restrictions on Trading Securities by Associated Persons

(e)(1) No associated person or member of the associated person's household may purchase or receive an issuer's securities prior to its initial public offering (e.g., so-called pre-IPO shares), if the issuer is principally engaged in the same types of business as companies (or in the same industry classification) which the associated person usually covers in research reports.

(2) No associated person or member of the associated person's household may trade in any recommended subject company's securities or derivatives of such securities for a period of thirty (30) calendar days prior to and five (5) calendar days after the member's or member organization's issuance of research reports concerning such security or a change in rating or price target of a subject company's securities.

(3) No associated person or member of the associated person's household may effect trades contrary to the member's or member organization's most current recommendations (i.e., sell securities while maintaining a "buy" or "hold" recommendation, buy securities while maintaining a "sell" recommendation, or effecting a "short sale" in a security while maintaining a "buy" or "hold" recommendation on such security).

(4) The following are exceptions to the prohibitions contained in paragraphs (1), (2), and (3):

(i) Transactions by associated persons and household members that have been pre-approved in writing by the Legal or Compliance Department that are made due to an unanticipated significant change in their personal financial circumstances;

(ii) A member or member organization may permit the issuance of research reports or permit a change to the rating or price target on a subject company, regardless of whether an associated person and/or household members traded the subject company's securities or derivatives of such securities, within the thirty (30) calendar day period described in paragraph (e)(2), when the issuance of such research reports, or change in such rating or price target is attributable to some significant news or events regarding the subject company, provided that the issuance of such research reports, or change in rating or price target on such subject company has been pre-approved in writing by the Legal or Compliance Department;

(iii) Sale transactions by an associated person and/or household member who is new to the member or member

organization within thirty (30) calendar days of such associated person's employment with the member or member organization when such associated person and/or household member had previously purchased such security or derivatives of such security prior to the associated person's employment with the member or member organization;

(iv) Sale transactions by an associated person and/or household member within thirty (30) calendar days from the date of the member's or member organization's issuance of research reports or changes to the rating or price target on a subject company when such associated person and/or household member had previously purchased the subject company's securities or derivatives of such securities prior to initiation of coverage of the subject company by the associated person;

(v) Transactions in accounts not controlled by the associated person and for investment funds in which an associated person or household member participates as a passive investor, provided the interest of the associated person or household member in the assets of the fund does not exceed 1% of the fund's assets, and the fund does not invest more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies (or in the same industry classification) which the associated person usually covers in research reports. If an investment fund distributes securities in kind to an associated person before the issuer's initial public offering, the associated person must either divest those securities immediately or refrain from participating in the preparation of research reports concerning that issuer;

(vi) Transactions in a registered diversified investment company as defined under Section 5(b)(1) of the Investment Company Act of 1940.

#### Restrictions on Member's or Member Organization's Issuance of Research Reports and Participation in Public Appearances

(f)(1) A member or member organization may not issue research reports regarding an issuer or recommend an issuer's securities in a public appearance, for which the member or member organization acted as manager or co-manager of an initial public offering within forty (40) calendar days following the effective date of the offering.

(2) A member or member organization may not issue research reports regarding an issuer or recommend an issuer's securities in a public appearance, for

which the member or member organization acted as manager or co-manager of a secondary offering within ten (10) calendar days following the effective date of the offering. This prohibition shall not apply to research reports issued under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(3) A member or member organization may permit exceptions to the prohibitions in paragraphs (f)(1) and (2) (consistent with other securities laws and rules) for research reports that are issued due to significant news or events, provided that such research reports are pre-approved in writing by the member's or member's organization's Legal or Compliance Department.

(4) No member or member organization which has acted as a manager or co-manager of a securities offering may issue a research report or make a public appearance within fifteen (15) days prior to or after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member or member organization has entered into with a subject company and its shareholders that restricts or prohibits the sale of the subject company's or its shareholder's securities after the completion of a securities offering. A member or member organization may permit exceptions to the prohibitions in paragraph (f)(4) (consistent with other securities laws and rules) for research reports that are issued as a result of the development of significant news or events, provided that such research reports are pre-approved in writing by the member's or member organization's Legal or Compliance Department.

(5) If a member or member organization withdraws its research coverage of a subject company, notice of this withdrawal must be made. Such notice must be made in the same manner as when research coverage was first initiated by the member or member organization and must include the member's or member organization's final recommendation or rating.

#### Prohibition of Offering Favorable Research for Business

(g) No member or member organization may directly or indirectly offer a favorable research rating or specific price target, or offer to change a rating or price target, to a subject company as consideration or inducement for the receipt of business or for compensation.

#### Restrictions on Compensation to Associated Persons

(h)(1) No member or member organization may compensate an associated person(s) for specific investment banking services transactions. An associated person may not receive an incentive or bonus that is based on a specific investment banking services transaction. However, a member or member organization is not prohibited from compensating an associated person based upon such member's or member organization's [person's] overall performance, including [services provided to] the performance of the Investment Banking Department (see Rule 472(k)(2) for disclosure of such compensation).

(2) An associated person's compensation must be reviewed and approved at least annually by a committee which reports to the Board of Directors or where the member or member organization has no Board of Directors to a senior executive officer of the member or member organization. Such committee may not include representatives from the member's or member organization's Investment Banking Department. The committee must, among other things, consider the following factors, if applicable, when reviewing an associated person's compensation:

- i. The associated person's individual performance, (e.g., productivity, and quality of research product);
- ii. The correlation between the associated person's recommendations and stock price performance;
- iii. The overall ratings received from clients, sales force, and peers independent of the Investment Banking Department, and other independent rating services.

The committee may not consider as a factor in determining the associated person's compensation, his or her contributions to the member's or member organization's investment banking business.

The committee must document the basis upon which each associated person's compensation was established. The annual attestation required by Rule 351(f) must certify that the committee reviewed and approved each associated person's compensation and has documented the basis upon which such compensation was established.

#### General Standards for All Communications

(Formerly positioned at Supplementary Material .30)

- (i) No change

#### Specific Standards for Communications (Formerly positioned at Supplementary Material .40)

(j) No change (except for deletion of .40(2)).

#### Disclosure

##### (k)(1) Disclosures Required in Research Reports and Public Appearances

##### Disclosure of Member's, Member Organization's and Associated Person's Ownership of Securities

(i) A member or member organization must disclose in research reports and an associated person must disclose in public appearances:

a. If, as of the last day of the month before the publication or appearance (or the end of the second most recent month if the publication or appearance is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934,

b. If the associated person or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position, or

c. Any other actual, material conflict of interest of the member or member organization, which the associated person knows, or has reason to know, at the time the research report is issued or at the time the public appearance is made.

##### Member, Member Organization and Affiliate Compensation

(ii) A member or member organization must disclose in research reports if the member or member organization or its affiliates: a) Has managed or co-managed a public offering of equity securities for the subject company in the past twelve (12) months; b) has received compensation for investment banking services from the subject company in the past twelve (12) months; or c) expects to receive or intends to seek compensation for investment banking

services from the subject company in the next three (3) months.

When an associated person recommends securities in a public appearance, the associated person must disclose if the subject company is an investment banking services client of the member, member organization, or one of its affiliates; when the associated person knows or has reason to know of this relationship.

#### Disclosure of Associated Person's Affiliations With Subject Company

(iii) A member or member organization must disclose in research reports, and an associated person must disclose in public appearances, whether the associated person or member of the associated person's household is an officer, director or advisory board member of the recommended issuer.

#### (k)(2) Disclosures Specific to Research Reports

The front page of a research report either must include the disclosures required under this Rule or must refer the reader to the page(s) on which each such disclosure is found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent.

A member or member organization must disclose in research reports if the associated person preparing such reports received compensation that is based upon (among other factors) the member's or member organization's overall investment banking revenues.

A member or member organization must disclose in research reports that recommend securities:

(i) If it is making a market in the subject company's securities at the time the research report is issued.

(j) The valuation methods used, and any price objectives must have a reasonable basis and include a discussion of risks.

(iii) The meanings of all ratings used by the member or member organization in its ratings system. (For example, a member or member organization might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next 12-month period). Definitions of ratings terms also must be consistent with their plain meaning. Therefore, for example, a "hold" rating should not mean or imply that an investor should sell a security.

(iv) The percentage of all securities that the member or member organization recommends an investor "buy," "hold," or "sell." Within each of the three categories, a member or member organization must also disclose

the percentage of subject companies that are investment banking services clients of the member or member organization within the previous twelve (12) months. (See Rule 472.70 for further information.)

(v) A chart that depicts the price of the subject company's stock over time and indicates points at which a member or member organization assigned or changed a rating or price target. This provision would apply only to securities that have been assigned a rating for at least one year, and need not extend more than three years prior to the date of the research report. The information in the price chart must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter).

When a member or member organization distributes a research report covering six (6) or more subject companies for purposes of the disclosures required in paragraph (k) of this Rule, such research report may direct the reader in a clear and prominent manner as to where they may obtain applicable current disclosures in written or electronic format.

#### Other Communications Activities

*(l) Other communications activities are deemed to include, but are not limited to, conducting interviews with the media, writing books, conducting seminars or lecture courses, writing newspaper or magazine articles or making radio/TV appearances.*

*Members and member organizations must establish specific written supervisory procedures applicable to members, allied members and employees who engage in these types of communications activities. These procedures must include provisions that require prior approval of such activity by a person designated under the provisions of Rule 342(b)(1). These types of activities are subject to the general standards set forth in paragraph (i). In addition, any activity which includes discussion of specific securities and/or industries is subject to the specific standards in paragraph (j) and the disclosure requirements of paragraphs (k)(1) and (k)(2)(i).*

#### .10 Definitions

(1) Communication—The term "Communication" is deemed to include, but is not limited to, advertisements, market letters, research reports, sales literature, electronic communications, communications in and with the press and wires and memoranda to branch offices or correspondent firms which are

shown or distributed to customers or the public.

(2) Research Report—"Research report" is generally defined as a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and provides information reasonably sufficient upon which to base an investment decision. [and includes a recommendation].

For purposes of approval by a supervisory analyst pursuant to Rule 472(a)(2), research report includes, but is not limited to, reports which recommend equity securities, derivatives of such securities, including options, debt and other types of fixed income securities, single stock futures products, and other investment vehicles subject to market risk.

(3) Advertisement—"Advertisement" is defined to include, but is not limited to, any sales communications that is published, or designed for use in any print, electronic or other public media such as newspapers, periodicals, magazines, radio, television, telephone recording, web sites, motion pictures, audio or video device, telecommunications device, billboards or signs.

(4) Market letters—"Market letters" are defined as, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles *that are not defined as research reports*. They also may include "follow-ups" to research reports and articles prepared by members or member organizations which appear in newspapers and periodicals.

(5) Sales literature—"Sales literature" is defined as, but is not limited to, written or electronic communications including, but not limited to, telemarketing scripts, performance reports or summaries, form letters, seminar texts, and press releases discussing or promoting the products, services and facilities offered by a member or member organization, the role of investment in an individual's overall financial plan, or other material calling attention to any other communication.

.20 For purposes of this Rule, "investment banking services" includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

.30 For purposes of this Rule, the term "Investment Banking Department" means any department or division of the member or member organization, whether or not identified as such, that performs any investment banking services on behalf of the member or member organization.

.40 For purposes of this Rule, the term "associated person" includes a member, allied member, or employee of a member or member organization responsible for, and any person who reports directly or indirectly to such associated person in connection with, the *preparation* of [making of the recommendation to purchase, sell or hold an equity security in] research reports, or *making recommendations or offering opinions* in public appearances or establishing a rating or price target of a subject company's equity securities. For purposes of this Rule, the term "household member" means any individual whose principal residence is the same as the associated person's principal residence. Paragraphs (e)(1), (2), (3); (4)(i), (ii), (iii), (iv) and (v); (k)(1)(i)b., (k)(1)(iii) apply to any account in which an associated person has a financial interest, or over which the associated person exercises discretion or control, other than an investment company registered under the Investment Company Act of 1940.

*This term "associated person" also includes such "other persons," e.g., Director of Research, Supervisory Analyst, or member of a committee, who have direct influence and/or control with respect to (1) preparing research reports, or (2) establishing or changing a rating or price target of a subject company's equity securities. Such other persons are subject to the provisions of paragraph (e)(1)–(4) of this Rule.*

.50 For purposes of this Rule, the term "public appearance" includes, without limitation, participation in a seminar, forum (including an interactive electronic forum), radio, [or] television or *print media* interview, or other public appearance or public speaking activity, or the *writing of a newspaper article or other type of public written medium* in which an associated person makes a recommendation or offers an opinion concerning any equity securities *and/or industries*.

.60 For purposes of this Rule, "subject company" is the company whose equity securities are the subject of research reports.

.70 For purposes of Rule 472(k)(2)(iv), a member or member organization must determine, based on its own ratings system, into which of the three categories each of their securities ratings utilized falls. This information

must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter). For example, a research report might disclose that the member or member organization has assigned a "buy" rating to 58% of the securities that it follows, a "hold" rating to 15%, and a "sell" rating to 27%.

Rule 472(k)(2)(iv) requires members or member organizations to disclose the percentage of companies that are investment banking services clients for each of the three ratings categories within the previous twelve (12) months. For example, if 20 of the 25 companies to which a member or member organization has assigned a "buy" rating are investment banking clients of the member or member organization, the member or member organization would have to disclose that 80% of the companies that received a "buy" rating are its investment banking clients. Such disclosure must be made for the "buy," "hold" and "sell" ratings categories as appropriate.

.80 For purposes of this Rule, the term "Legal or Compliance Department" also includes, but is not limited to, any department of the member or member organization which performs a similar function.

.90 For purposes of Rule 472(a), a qualified person is one who has passed an examination acceptable to the Exchange.

.100 For purposes of this Rule, the term "initial public offering" refers to the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement.

.110 For purposes of this Rule, a secondary offering shall include a registered follow-on offering by an issuer or a registered offering by persons other than the issuer involving the distribution of securities subject to Regulation M of the Securities Exchange Act of 1934.

### Reporting Requirements

#### Rule 351

- (a)–(e) No change.
- (f) Each member and member organization that prepares, issues or distributes [communications to the public, (including but not limited to,) research reports and *whose associated persons make public appearances* [, media presentations and interviews]], is required to submit to the Exchange

annually, a letter of attestation signed by a senior officer or partner that the member or member organization has established and implemented procedures reasonably designed to comply with the provisions of Rule 472. *The attestation must also specifically certify that each associated person's compensation was reviewed and approved in accordance with the requirements of Rule 472(h)(2) and that the basis for such approval has been documented.*

\* \* \* \* \*

.11 For purposes of Rule 351(f), the attestation must be submitted by April 1 of each year.

.12 The term "research report" is defined in Rule 472.10 and the term "public appearance" is defined in Rule 472.50.

### Securities Analysts and Supervisory Analysts

Rule 344. *Securities analysts and supervisory analysts must be registered with, qualified by, and approved by the Exchange.*

[Supervisory analysts required under Rule 472 shall be acceptable to, and approved by, the Exchange.]

.10 For purposes of this Rule, the term "securities analyst" includes a member, allied member or employee who is directly responsible for the preparation of research reports. *Securities analyst candidates must pass a qualification examination acceptable to the Exchange.*

.11 [.10] For purposes of this rule, the term "supervisory analyst" includes a member, allied member or employee who is responsible for approving research reports under Rule 472(a)(2). In order to show evidence of acceptability to the Exchange as a supervisory analyst, a member, allied member or employee may do one of the following:

- (1) Present evidence of appropriate experience and pass an Exchange Supervisory Analysts Examination.
- (2) Present evidence of appropriate experience and successful completion of a specified level of the Chartered Financial Analysts Examination prescribed by the Exchange and pass only that portion of the Exchange Supervisory Analysts Examination dealing with Exchange rules on research standards and related matters.

[In addition, if not a member, allied member or registered representative, the candidate is subject to Exchange investigation of character and conduct and should submit personal information on Form U-4 for this purpose.]

The Exchange publishes a Study Outline for the *Securities Analyst Examination and the Supervisory*

*Analysts Examination.* [Examinations are requested and given under the procedures described in Para. of 2345.15 for registered representative examinations.]

**Continuing Education for Registered Persons**

Rule 345A.(a) Regulatory Element—No change.

(b) Firm Element

(1) Persons Subject to the Firm Element—The requirements of Section (b) of this Rule shall apply to any registered person who has direct contact with customers in the conduct of the member's or member organization's securities sales, trading or investment banking activities, and to the immediate supervisors of such persons, *and to registered persons who function as supervisory analysts, and securities analysts as defined in Rule 344* (collectively, "covered registered persons").

(2) Standards—No Change.

(3) Participation in the Firm Element—No Change.

(4) Specific Training Requirements—The Exchange may require a member or member organization, either individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the Exchange deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

.10 For purposes of this Rule, the term "registered person" means any member, allied member, registered representative or other person registered or required to be registered under Exchange rules, but does not include any such person whose activities are limited solely to the transaction of business on the Floor with members or registered broker-dealers. *For purposes of the Regulatory Element required under Rule 345A(a), the term does not include persons registered as securities analysts or supervisory analysts pursuant to Rule 344.*

.20–.40 No Change.

.50 Pursuant to Rule 345A(b)(1), all persons registered as securities analysts and supervisory analysts pursuant to Rule 344 must participate in a Firm Element Continuing Education program that includes training in applicable rules and regulations, ethics and professional responsibility.

\* \* \* \* \*

The Exchange is requesting the following implementation schedule for

the proposed amendments (all time periods are from the date that the Commission approves the filing) in order to provide reasonable time periods for members and member organizations to develop and implement policies, procedures and systems to comply with the new requirements:

- NYSE Rule 345A(b) and .50—Implementation of a Firm Element Continuing Education Program for Research Analysts—90 calendar days.
- All other provisions—60 calendar days.

In addition, the Exchange is proposing an effective date of 180 days after approval of the amendments to NYSE Rule 344.10 to provide sufficient time for the Exchange to develop and implement a qualification examination for research analysts.

**B. NASD's Proposed Rule Text**

*Rule 1050. Registration of Research Analysts*

*All persons associated with a member who are to function as research analysts shall be registered with NASD. Before their registrations can become effective, they shall pass a Qualification Examination for Research Analysts as specified by the Board of Governors. For the purposes of this Rule 1050, "research analyst" shall mean an associated person who is directly responsible for the preparation of research reports.*

\* \* \* \* \*

**Rule 1120. Continuing Education Requirements**

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with the Association. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1)–(4) (No change.)

(5) Definition of Registered Person

For purposes of this Rule, the term "registered person" means any person registered with [the Association] NASD as a representative, principal, [or] assistant representative or research analyst pursuant to Rule 1020, 1030, 1040, 1050 and 1110 Series.

(6) (No change.)

(b) Firm Element

(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with the member who has

direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, and to the immediate supervisors of such persons, *and to any person registered as a research analyst pursuant to Rule 1050* (collectively, "covered registered persons").

"Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

(2) Standards for the Firm Element

(A) (No change.)

(B) Minimum Standards for Training Programs—Programs used to implement a member's training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

- (i) General investment features and associated risk factors;
- (ii) Suitability and sales practice considerations; [and]
- (iii) Applicable regulatory requirements[.]; and
- (iv) With respect to registered research analysts, training in ethics, professional responsibility and the requirements of Rule 2711.

(3)–(4) (No change.)

\* \* \* \* \*

**Rule 2711. Research Analysts and Research Reports**

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1)–(3) (No change.)

(4) "Public appearance" means any participation in a seminar, forum (including an interactive electronic forum), radio, [or] television or print media interview, or other public speaking activity, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

(5) "Research analyst" means the associated person who is principally responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of "research analyst." *Solely for purposes of paragraph (g), the term "research analyst" also includes such other persons as the director of research, supervisory analyst, or*

member of a committee who have direct influence or control with respect to (A) the preparation of research reports, or (B) establishing or changing a rating or price target of a subject company's equity securities.

(6)–(7) (No change.)

(8) “Research report” means a written or electronic communication which includes an analysis of equity securities or individual companies or industries, and which provides information reasonably sufficient upon which to base an investment decision [and includes a recommendation].

(9) (No change.)

(b) (No change.)

(c) Restrictions on Review of a Research Report by the Subject Company

(1)–(3) (No change.)

(4) No research analyst may issue a research report or make a public appearance concerning a subject company if the research analyst engaged in any communication with the subject company in furtherance of obtaining investment banking business prior to the time the subject company entered into a letter of intent or other written agreement with the member designating the member as an underwriter of an initial public offering by the subject company. This provision shall not apply to any due diligence communication between the research analyst and the subject company, the sole purpose of which was to analyze the financial condition and business operations of the subject company.

(d) [Prohibition of Certain Forms of] Restrictions on Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) A research analyst's compensation must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing a research analyst's compensation, if applicable:

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in determining the research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each research analyst's compensation and documented the basis upon which this compensation was established.

(e) (No change.)

(f) [Imposition of Quiet Periods] Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage

(1) No member may publish a research report regarding a subject company or recommend a subject company's securities in a public appearance for which the member acted as manager or co-manager of:

[(1)](A) an initial public offering, for 40 calendar days following the date of the offering; or

[(2)](B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

[(A)](i) paragraphs (f)(1)(A) and (f)(2)(1)(B) will not prevent a member from publishing a research report concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that the legal and compliance department authorizes publication of that research report before it is issued; and

[(B)](ii) paragraph (f)(2)(1)(B) will not prevent a member from publishing a research report pursuant to SEC Rule 139 regarding a subject company with “actively-traded securities,” as defined in Regulation M, 17 CFR 242.101(c)(1).

(3) No member that has acted as a manager or co-manager of a securities offering may publish a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent

a member from publishing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided that the legal and compliance department authorized publication of that research report before it is issued.

(4) If a member intends to discontinue its research coverage of a subject company, notice of this withdrawal must be made in the same manner as when research coverage was first initiated by the member and must include the member's final recommendation or rating.

(g)–(i) (No change.)

## II. Self-Regulatory Organization's Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

In their filings with the Commission, the NYSE and NASD included statements concerning the purpose of and basis for the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The NYSE and NASD have prepared summaries, set forth in Sections A, B, and C below.

### A. Self-Regulatory Organizations' Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

#### 1. NYSE's Purpose

##### Background

NYSE believes that allegations regarding improprieties in solicitation of investment banking business impugn the objectivity and integrity of research analysts and the reports they prepare and have continued to undermine investor confidence in the equity markets. According to the NYSE, in discharging their duties as SROs, the NYSE and NASD have been proactive in this regard and have passed sweeping changes, described below, to their rules governing research analysts, their member organizations and their communications with the public. The proposed amendments described below are a continuation of this process to restore integrity to the public equity markets.

##### Prior Amendments

On May 10, 2002, the SEC approved amendments to Exchange Rules 472 and 351 which significantly changed the manner in which members and member organizations, their investment-banking departments and their research analysts manage and disclose conflicts of interest between their investment banking and research activities. The SEC also

simultaneously approved comparable changes to NASD rules (new NASD Rule 2711—"Research Analysts and Research Reports"). NYSE believes that these rule amendments are the result of the SROs working to develop uniform industry rules.

The rule amendments generally restrict the relationship between research and investment banking departments and the companies that are the subject of research reports; require disclosure of a financial interest in a subject company by an analyst or a member or member organization; require disclosure of existing and potential investment banking relationships with a subject company; impose quiet periods for the issuance of research reports following the completion of a company's securities offering; restrict personal trading by research analysts in the stock of the companies covered by such analysts; and generally require extensive disclosure in research reports of certain important information to help customers monitor the correlation between an analyst's rating and the stock's price movements.

The rule amendments have been phased-in incrementally to provide members and member organizations time to develop and implement policies, procedures and systems and hire additional personnel to comply with the new requirements. The staggered implementation of the Rules began July 9, 2002, with September 9, 2002 and November 6, 2002 as the effective dates for certain specified provisions. Implementation dates for certain of the SRO rules have also been delayed for small firms. As a result of numerous interpretive requests, on June 26, 2002, the Exchange and the NASD issued a Joint Memo providing interpretive guidance to certain rule provisions.<sup>6</sup>

According to NYSE, the Exchange, together with other regulatory organizations and SROs, is currently examining members' and member organizations' research practices to determine compliance with the new SRO Rules.

According to the NYSE, some of the interpretive issues raised by the industry and the preliminary findings from the recent examinations have highlighted the need for certain additional changes to the existing SRO Rules. NYSE believes that further amendments to the SRO rules will also be required to comply with the mandate of the Sarbanes-Oxley Act of 2002

("SOA"), which requires the SEC, either directly or indirectly through SROs, to adopt not later than one year after the date of enactment of the Act (July 24, 2002), "rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information."

According to the NYSE, certain of the disclosure requirements and prohibitions that the SOA mandates have already been adopted in the new NYSE Rules. In some cases, the SOA appears to impose more stringent requirements. The NYSE is currently analyzing the differences between the SOA and NYSE Rules, to determine the extent of additional amendments to be made.

#### *Proposed Amendments Regarding Research Analysts*

The following proposed amendments to Exchange rules governing communications with the public expand upon the recently approved rule changes. The amendments generally provide for further restrictions on research analysts' compensation and trading activities, and impose additional disclosure requirements for research reports and associated persons.

Proposed amendments to Rule 472 would further separate an analyst's compensation from investment banking influence by requiring procedures for review and approval of research analysts' compensation by a Committee that reports to the Board of Directors or a senior executive. Recently approved amendments prohibit an associated person from being compensated for specific investment services transactions.

Such a Committee, at a minimum, would consider the following factors: the associated person's individual performance (*e.g.*, quality of research product), correlation between a research analyst's recommendations and stock prices, and overall ratings from various internal or external parties exclusive of member or member organization investment banking personnel.

Further, in determining an individual research analyst's compensation, the Committee may not consider his or her contribution to the firm's overall investment banking business. The basis for a research analyst's compensation would have to be documented and an annual attestation to the Exchange would certify that the Committee reviewed and approved each associated person's compensation and documented

the basis for such approval (Rule 472(h)(1) and (2)).

Proposed Rule 472(b)(4) will prohibit a research analyst from issuing a research report or making a public appearance concerning a subject company if the research analyst engaged in any communication with the subject company in furtherance of obtaining investment banking business prior to the time the subject company entered into a letter of intent or other written agreement with the member or member organization designating the member or member organization as an underwriter of an initial public offering by the subject company.<sup>7</sup> Prohibiting research analysts from issuing research reports or making public appearances after participating in "pitch" meetings is intended to prevent the use or promise of research as an influence or a sales and marketing tool with prospective investment banking clients of the member or member organization, and would cause subject companies to choose a prospective investment banking firm based on the merits of its underwriting capabilities, rather than its research coverage.<sup>8</sup>

Due diligence communications between the research analyst and the subject company, the sole purpose of which is to analyze the financial condition and business operations of the subject company, is not subject to the prohibition. Recognizing the need for critical financial analysis of a subject company during the period an issuer is preparing to engage in a securities offering with the public, the rule allows research analysts to participate in due diligence communications. In doing so, the rule is intended to segregate legitimate research analyst duties/functions, traditionally associated with their profession, from the sales/marketing duties that they may have been called upon recently to do by their firms.

Proposed amendments to Rule 472 would prohibit the issuance of research reports by the manager or co-manager of a securities offering for fifteen (15) days prior to and after the expiration time of any "lock-up agreement" (Rule 472(f)(4)). This provision is intended to address situations where research analysts may issue positive research reports or reiterated "buy" recommendations shortly before or just after the expiration of a lock-up agreement. Through issuance or reiteration of "buy" recommendations,

<sup>7</sup> Telephone conversation between NYSE and Division Staff on December 30, 2002.

<sup>8</sup> Telephone conversation between NYSE and Division Staff on December 30, 2002.

<sup>6</sup> NYSE Information Memo No. 02-26 (June 26, 2002), and NASD Notice to Members 02-39 (July 2002).

shareholders of the subject company which were precluded from selling shares in the immediate aftermarket for specified periods of time, may be able to sell their shares at higher prices. Imposition of this fifteen (15) day blackout period around the expirations of lockups is intended to mitigate and/or eliminate the incentive for a research analyst to issue positive research reports, and should permit real market forces to determine the price at which such securities can be sold after the expiration of such agreements.

Proposed amendments to Rule 472 would require notification to customers when a member or member organization terminates research coverage of a subject company and require that the final report include a final recommendation or rating<sup>9</sup> (assuming the member or member organization had issued a prior rating or recommendation)<sup>10</sup> (Rule 472(f)(5)). This provision is intended to address situations where research analysts have discontinued following subject companies without changing their ratings of such companies, even though ratings changes, may have in many instances, been warranted. Thus, investors held the securities of such companies, often while these companies were deteriorating financially, without the benefit of guidance from the firms from which they had purchased them. The recently approved amendments to Rule 472 also address this issue, in part, by requiring the disclosure of a price chart versus changes in ratings in order to help investors track the correlation between a research analyst's rating/recommendation and the stock's price performance. NYSE believes that the proposed amendments would enhance this required disclosure by providing investors with notice of termination of coverage as well as any final rating the member or member organization has issued on the subject company.

As proposed, the definition of research analyst (associated person) would be amended to include research directors, supervisory analysts and others *e.g.*, committee members, who have direct influence, or control the preparation of research reports and establishment or change in ratings or price targets and thereby subject them to the trading and ownership prohibitions of the Rule (Rule 472.40) as research analysts.

As proposed, the current ten (10) and forty (40) day quiet periods for research

analysts' issuance of research reports by managers and co-managers of initial and secondary offerings would be extended to include public appearances (Rule 472(f)(1) and (2)). Extending the quiet periods to public appearances would preclude members and member organizations from engaging in communications through public appearances that they are otherwise prohibited from making in written communications to the same standards. NYSE believes that subjecting all types of appearances and written communications should further remove any incentives for biased research recommendations in any potential type of medium.

The definition of "public appearance" would be amended to include research analysts' making a recommendation in a newspaper article or similar public medium (Rule 472.50). Extending the definition of public appearance to recommendations in a newspaper article would require research analysts to make the same disclosures that they are required to make in other public appearances.<sup>11</sup>

Proposed amendments to Rule 344 ("Supervisory Analysts") would establish a new registration category and require a qualification examination for research analysts (Rule 344). In addition, Rule 345A ("Continuing Education for Registered Persons") would be amended to include research analysts and supervisory analysts as covered persons subject to the Firm Element of the Continuing Education Program to address applicable rules and regulations, ethics, and professional responsibility (Rule 345A(b) and .50).

NYSE believes that research analysts as securities professionals perform vital functions for their members or member organizations in the public equity markets. As such, they should be subject to the highest ethical and professional competency standards. Accordingly, NYSE believes that establishing a new registration category with a corresponding qualifying examination will raise such standards. Further, including research and supervisory analysts as covered persons in the Firm Element component of Continuing Education Programs would place an obligation on members and member organizations to ensure that they are receiving the requisite ethics and professional responsibility training that NYSE believes they will require to

properly conduct their duties as research analysts.

The Exchange is making certain clarifying amendments to Rule 472 that would make it more uniform with the NASD rule and would bring it into conformity with certain of the new requirements of the Act.

Rule 472 is being amended to require that the nature of a research analyst's financial interest in a subject company's securities be disclosed in research reports and public appearances, including whether the interest consists of any option, right, warrant, futures contract, or long or short position, etc. This would make NASD and NYSE rule texts consistent with each other (Rule 472(k)(1)(i)(b)).

Proposed amendments to Rule 472(l) with respect to specified communications activities, including, interviews with the media, writing books and newspaper/periodical articles etc., engaged in by members, allied members or employees, would clarify the approval and supervisory requirements for such activities.

As proposed, the term "research report" as it is currently defined in the Rule 472 is being amended to conform to the Act's definition by deleting the criterion of providing a recommendation from the criteria that determines what constitutes a research report (Rule 472.10(2)). NYSE believes conforming the definition to the one required by the SOA would help facilitate members' and member organizations' future compliance with the SOA in the least disruptive manner.

## 2. NYSE's Statutory Basis

The NYSE believes that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act<sup>12</sup> which requires, among other things, that the rules of the Exchange are 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 interests.

## 3. NASD's Purpose Background

In May 2002, the SEC approved new NASD Rule 2711 and similar amendments to existing New York Stock Exchange ("NYSE") rules that increased the regulation of research analysts and research reports.<sup>13</sup> The new rules are intended to improve the objectivity of

<sup>9</sup> The Exchange requested that Commission Staff delete the reference to a final recommendation or rating "if any" in order to conform to changes made by NYSE Amendment No. 1.

<sup>10</sup> Telephone conversation between NYSE and Division Staff on December 30, 2002.

<sup>11</sup> The Exchange requested that Commission Staff delete the reference to "research reports." Telephone conversation between NYSE and Division Staff on December 30, 2002.

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> *Supra* note 5, *m See also* Securities Exchange Act Release No. 46402 (June 6, 2002), 67 FR 40361 (June 12, 2002)(correcting language contained in rule 2711(h)).

research and provide investors with more useful and reliable information when making investment decisions. Most of the new rules' provisions became effective on July 9, 2002, although some provisions took effect on September 9, 2002, and one provision took effect on November 6, 2002. Additionally, in July 2002, the SEC approved a NASD rule proposal to delay until November 6, 2002 the effectiveness of certain provisions for certain members with foreign affiliates, certain research analysts that are divesting the securities of all subject companies that they cover, and certain defined small firms.<sup>14</sup>

In June 2002, NASD and the NYSE issued a joint memorandum that provided members with the new rule language, as well as interpretive guidance on a number of Rule 2711's provisions.<sup>15</sup> NASD and the NYSE also have been examining members' research practices to determine compliance with the new research analyst rules.

According to NASD, as a result of the examinations and further discussions with the SEC staff, NASD and NYSE agreed that additional rules governing members' research activities are necessary to protect investors. This rule change proposal would effectuate those additional safeguards. Generally, the proposed amendments would further separate analyst compensation from investment banking influence, prohibit analysts from issuing "booster shot" research reports, prohibit analysts from participating in "bake-off" meetings with prospective investment banking clients, require members to publish a final research report when they terminate coverage of a subject company, impose registration, qualification and continuing education requirements on research analysts, and make certain other changes.

NASD believes that these amendments do not implement all of the changes that may be required pursuant to the research analyst provisions of the SOA. NASD anticipates filing additional proposed amendments to Rule 2711 in the future to meet the requirements of SOA after further discussions with NYSE and SEC staff.

A more detailed discussion of the proposed rule change follows.

#### 1. Analyst Compensation

The proposed amendments would require members to further separate analyst compensation from investment

banking influence by imposing new restrictions on the manner in which research analysts may be compensated. The rule proposal would require members to employ a compensation committee that reports to the member's board of directors (or if the member does not have a board of directors, a senior executive officer of the member) responsible for reviewing and approving analyst compensation at least annually. The committee could not have representation from the member's investment banking department. In determining an analyst's compensation, the committee would have to consider, if applicable, the research analyst's individual performance, including the analyst's productivity and research quality, the correlation between the analyst's recommendations and stock price performance, and overall ratings of clients, sales force, and peers independent of the member's investment banking department. The committee could not consider the analyst's contributions to the member's investment banking business.

The committee would be required to document the basis for establishing the analyst's compensation. The member also would have to attest annually to NASD that the committee reviewed and approved each analyst's compensation and documented the basis upon which the compensation was established.

#### 2. Restrictions on Publishing Research Reports and Public Appearances

The proposed amendments would make several changes to current Rule 2711(f), which imposes "quiet periods" on members during which members may not publish research reports following an initial or secondary public offering of securities. First, the proposed amendments would extend the quiet period prohibitions to public appearances by research analysts as well as to the issuance of research reports.

Second, the proposed amendments would prohibit "booster shot" research reports or public appearances around the time of the expiration, waiver or termination of a "lock-up" agreement. Members often enter into lock-up agreements with subject companies or their shareholders that restrict or prohibit the sale of a subject company's or its shareholder's securities for a defined period after the completion of a securities offering. This provision would prohibit members from publishing a research report or making a public appearance concerning a subject company for 15 days prior to or after the expiration, waiver or termination of a lock-up agreement, thus helping prevent members from

publishing favorable research that is intended to benefit the shareholders whose lock-up agreement is no longer in effect by driving up the price of the issuer's shares. However, the rule proposal includes an exception that would allow members to publish research reports during this quiet period to comment on the effect of significant news or a significant event on the subject company, provided that the legal and compliance department authorizes the publication of the report before it is issued. A similar exception exists with respect to quiet periods in the current rule.

Third, the proposed amendments would require a member that decides to terminate coverage of a subject company to publish a notice of this termination, and to publish its final rating or recommendation of the subject company's securities (assuming the member had issued a prior rating or recommendation). This provision is intended to eliminate the practice of dropping coverage of a subject company rather than lowering a rating or recommendation.

#### 3. Bake-Offs

The proposed amendments would prohibit a research analyst from issuing a research report or making a public appearance concerning a subject company if the research analyst communicated with the subject company in furtherance of obtaining investment banking business before the subject company had entered into a letter of intent or other written agreement designating the member as an underwriter of an initial public offering of the subject company. This provision would not apply to due diligence communications between an analyst and a subject company where the sole purpose is to analyze the financial condition and business operations of the subject company. The purpose of this provision is to prevent research analysts from attending "bake-off" meetings or otherwise communicating with a subject company where the intention is to pitch the member's investment banking services.

#### 4. Registration, Qualification and Continuing Education of Research Analysts

The proposed amendments would create new NASD Rule 1050, which would require all persons associated with a member that function as research analysts to register with NASD. For purposes of Rule 1050, "research analyst" would be defined as any associated person who is directly responsible for the preparation of

<sup>14</sup> See Securities Exchange Act Release No. 46165 (July 3, 2002), 67 FR 46555 (July 15, 2002).

<sup>15</sup> See Notice to Members 02-39 (July 2002).

research reports. Before these persons' registrations could become effective, they would be required to pass a qualification examination for research analysts specified by NASD. The proposed amendments also would amend Rule 1120 to require research analysts to participate in the regulatory element and firm element of a member's continuing education program. The firm element program would have to include research analysts' training and education in ethics, professional responsibility and the requirements of Rule 2711.

#### 5. Definitions

The proposed amendments would revise the definition of "research analyst" to include supervisors of research analysts, including directors of research and members of supervisory committees. The proposed expanded definition would apply only with respect to the personal trading restrictions of Rule 2711(g). NASD believes the amendment is necessary because these supervisory personnel review and often greatly influence the content of and recommendation contained in research reports and therefore should be subject to the same trading restrictions, such as the prohibition on trading against the member's recommendation. The other provisions of Rule 2711 that govern research analyst conduct and disclosures would not apply to supervisors of research analysts.

Additionally, the definition of "public appearance" would be revised to include interviews with print media and the writing of a print media article by a research analyst. In NASD's experience, the opinions and recommendations by research analysts made in the print media, specifically in opinion pieces, have created some of the same concerns as those made in radio and television appearances, which are covered by the current definition. NASD is modifying the guidance discussed in NASD's Notice to Members 02-39 concerning the making of the required disclosures in public appearances with media outlets. An analyst would not violate the rule if the analyst makes the required disclosures to the print, radio or television media in good faith, even if the media outlet does not print or broadcast the information. NASD thus recognizes the independent editorial discretion of the print, radio and television media.

#### 6. NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions

of Section 15A(b)(6)<sup>16</sup> of the Act, which require, among other things, that the NASD's rules 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 eliminate 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 Organizations' Statements on Burden on Competition*

NYSE and NASD do not believe that the proposed rule changes will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

#### *C. Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

NYSE and NASD has neither solicited nor received written comments on the proposed rule change.

#### **III. Date of Effectiveness of the Proposed Rule Changes 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 SROs consent, 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.

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

The Commission notes that the NYSE and NASD have worked together to develop these proposals. The Commission specifically requests comment on the substance of the proposals, and whether there are any differences between the NYSE and NASD proposals that present compliance or interpretive issues. The Commission also specifically seeks comment on the practicalities of making the required disclosures in print media and other public appearances. The Commission requests comment on

whether the SROs should consider whether there are other effective means (including abbreviated disclosures) to alert investors of conflicts in the context of public media appearances that would take into account possible space or time limitations.

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposals, as amended, are 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. Comments also may be submitted electronically to the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Electronically submitted comments will be posted on the Commission's Web site (<http://www.sec.gov>). All submissions should refer to File Nos. SR-NASD-2002-154 and SR-NYSE-2002-49 and should be submitted by March 10, 2003.

Copies of the rule filings, 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 the rule filings and amendments will also be available for inspection and copying at the principal offices of the SROs and on the SROs' respective Web sites (<http://www.nyse.com> and <http://www.nasd.com>).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. 03-223 Filed 1-6-03; 8:45 am]

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<sup>16</sup> 15 U.S.C. 78o-3(b)(6).

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