

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-54616; File Nos. SR-NYSE-2006-77; SR-NASD-2006-112)

October 17, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC and the National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Changes Relating to NYSE Rule 472 and NASD Rule 2711

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 September 27, 2006, the New York Stock Exchange LLC ("NYSE" or the "Exchange") and the National Association of Securities Dealers, Inc. ("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. The NYSE and NASD (the "SROs") have filed the proposed rule changes as constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of existing rules pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(1) thereunder,⁴ which renders them effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons.

I. Self-Regulatory Organizations' Statements of the Terms of Substance of the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(1).

Proposed Rule Changes

The Exchange proposes to amend NYSE Rule 472 to codify the Exchange's existing interpretive guidance relating to certain provisions of the rule and to make certain non-substantive, technical changes to the rule's text. The text of the proposed rule change is available on NYSE's Web site, <http://www.nyse.com>, at the NYSE's Office of the Secretary, and at the Commission's Public Reference Room.

NASD is proposing to amend NASD Rule 2711 to codify NASD's existing interpretive guidance relating to certain provisions of the rule and to make several non-substantive, technical changes to clarify the rule's intended meaning. The text of the proposed rule change is attached as Exhibit 5 to the NASD's rule filing.

II. Self-Regulatory Organizations' 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 and discussed any comments they received on 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, of the most significant aspects of such statements.

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

(1) NYSE's Purpose

Background

NYSE Rule 472 is, in significant part, intended to improve the objectivity of

research by requiring that investors be provided with conflict disclosures as well as other useful and reliable information with which to make investment decisions. Specifically, NYSE Rule 472 restricts the interaction between research departments and investment banking personnel; requires disclosure of financial interests in covered companies by the analyst and the firm; requires disclosure of existing and potential investment banking relationships with subject companies; imposes quiet periods for issuance of research reports; restricts personal trading by analysts; requires disclosure of information that helps investors track the correlation between an analyst's rating and the stock's price movements; requires that a compensation committee, without investment banking representation, review and approve compensation of research analysts; prohibits research analysts from participating in the solicitation of investment banking business; and prohibits research analysts from participating in road shows related to investment banking transactions.

Since the 2002 amendments to NYSE Rule 472,⁵ the Exchange has jointly published with NASD two memoranda that provide interpretive guidance to member organizations on a number of issues relating to NYSE Rule 472 and NASD's corresponding Rule 2711.⁶ Further, on December 21, 2005, the Exchange and the NASD submitted to the Commission a joint report on the operation and effectiveness of their respective rules relating to research analyst conflicts of interest (the "SRO Report"). Among the recommendations included in the SRO Report is that certain interpretations

⁵ See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) (order approving SR-NYSE-2002-09).

⁶ See NYSE Information Memo 02-26 (June 26, 2002) and NYSE Information Memo 04-10 (March 9, 2004).

set forth in the two joint memoranda be codified as rule text. Accordingly, the Exchange is herein proposing amendments to NYSE Rule 472 consistent with these recommendations.⁷

Specifically, the Exchange is proposing to amend NYSE Rule 472 to reflect the interpretive guidance relating to (1) the definition of the term "public appearance," (2) the definition of the term "research report," (3) the definition of the term "investment banking services," (4) the definition of the term "household member," (5) the definition of the term "equity security," (6) certain disclosure requirements, (7) compendium reports and (8) third-party research. In addition, the Exchange is proposing non-substantive, technical changes to NYSE Rule 472 where necessary to clarify the rule's intended meaning.

Definition of "Public Appearance"

NYSE Rule 472.50 currently defines "public appearance" as any participation in a seminar, forum (including an interactive electronic forum), radio, 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.

The proposed rule change codifies existing interpretive guidance to NYSE Rule 472 which will:

⁷ The SRO Report also recommended a number of substantive rule changes that extend beyond codifying existing interpretations of the provisions of NYSE Rule 472. As such, those changes are not included in this proposed rule change, which will take effect upon filing with the Commission pursuant to Section 19(b)(3)(A)(i) of the Act. Contemporaneously herewith, the Exchange filed a separate proposed rule change to implement those additional proposed amendments to NYSE Rule 472, SR-NYSE-2006-78.

(1) Include “conference calls” in the definition of “public appearance.”⁸

(2) Provide that a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security constitutes a public appearance only if presented before fifteen (15) or more persons (the “15-person standard”).⁹ If a member organization can reasonably ascertain at a public speaking activity before fifteen (15) or more persons that those persons represent less than fifteen (15) separate investors, then it will not constitute a public appearance. The NYSE believes the 15-person standard is consistent with the proposed rule change to amend the definition of “research report” in NYSE Rule 472 (discussed below) and SEC Regulation Analyst Certification (“Regulation AC”).¹⁰

(3) Clarify that any conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security before one or more representatives of the media constitutes a public appearance. Thus, a public speaking activity attended by at least one (1) representative of the media is a “public appearance” even if there are only three (3) other persons in attendance. The NYSE believes this interpretation is consistent with the current definition of “public appearance” which expressly includes radio, television and print media interviews because the media are a conduit to the public.

⁸ See NYSE Information Memo 02-26.

⁹ See NYSE Information Memo 04-10.

¹⁰ 17 CFR 242.500 et seq.

(4) Exclude from the definition of “public appearance” password-protected Webcasts, conference calls and similar events with fifteen (15) or more existing customers (either individuals or entities), provided that:

- (a) the event participants have previously received the most current research report or other documentation pertaining to the equity security in question that includes the disclosures required by NYSE Rule 472; and
- (b) the research analyst appearing at the event corrects or updates during the public appearance any disclosures that are inaccurate, misleading or no longer applicable.¹¹

Definition of “Research Report”

NYSE Rule 472.10(2) currently defines the term "research report" 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.

The proposed rule change would exclude from the definition of "research report" the following communications: (1) reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index; (2) reports commenting on economic, political or market conditions; (3) technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price; (4) statistical summaries of multiple companies' financial data, including listings of current ratings; (5) reports that

¹¹ See NYSE Information Memo 04-10.

recommend increasing or decreasing holdings in particular industries or sectors; and (6) notices of ratings or price target changes, provided that the member organization simultaneously directs the readers of the notice to the most recent research report on the subject company that includes all current applicable disclosures required by NYSE Rule 472 and that such research report does not contain materially misleading disclosure, including disclosures that are outdated or no longer applicable.¹²

The proposed rule change would codify an additional exclusion from the definition of "research report" for the following communications, even if they include an analysis of an individual security and information reasonably sufficient upon which to base an investment decision: (1) any communication distributed to fewer than fifteen (15) persons; (2) periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients that discuss individual securities in the context of a fund's or an account's past performance or the basis for previously made discretionary investment decisions; and (3) internal communications that are not given to customers. Thus, NYSE believes that, for example, a manager's discussion of fund performance in a mutual fund shareholder report would not constitute a research

¹² The NYSE believes that these exclusions essentially parallel those contained in SEC Regulation AC and the terms of the Research Analyst Global Settlement, an agreement among NASD, NYSE, the SEC, the North American Securities Administrators Association and twelve of the largest investment banks to resolve allegations regarding biased research. (See also NYSE Information Memos 02-26 and 04-10).

The Exchange notes that the proposed rule language to codify these interpretations may not be identical to that in the joint memoranda. The changes reflect, in part, the fact that the definition of "research report" was subsequently amended and no longer requires a recommendation. Also, in some instances, the Exchange has chosen language more appropriate for rule text. To the extent there are discrepancies, unless otherwise noted, the substance of the existing interpretations is not intended to be different than those set forth in the joint memoranda.

report.¹³

Additionally, the proposed rule change would codify an interpretation that communications that constitute statutory prospectuses that are filed as part of the registration statement are not considered "research reports," even if they otherwise satisfy the definitional elements. The NYSE believes this exemption recognizes that prospectuses serve different purposes than research reports and, thus, are subject to a separate comprehensive regulatory scheme.

Definition of "Investment Banking Services"

Under current NYSE Rule 472.20, the term "investment banking services" includes 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, or similar investments; or serving as a placement agent for the issuer.

The proposed rule change would codify existing interpretive guidance that the definition of "investment banking services" also includes acting as a member of a selling group in a securities underwriting.¹⁴

Definition of "Household Member"

Exchange Rule 472.40 currently defines the term "household member" to include any individual whose principal residence is the same as the research analyst's principal residence.

The proposed rule change would codify that the definition of "household member" does not include an unrelated person who shares the same residence as a

¹³ The NYSE believes that these exclusions parallel those contained in SEC Regulation AC. (See NYSE Information Memo 04-10).

¹⁴ See NYSE Information Memo 02-26.

research analyst provided that the research analyst and unrelated person are financially independent of one another. Thus, according to the NYSE, for example, an analyst's roommate or apartment mate, who is financially independent of the analyst, would not be considered a "household member" for purposes of the restrictions on personal trading and disclosure requirements in NYSE Rule 472.¹⁵

Definition of "Equity Security"

Currently, "equity security" is not defined in NYSE Rule 472. The proposed rule change would add "equity security" as a defined term in paragraph 472.140 and would codify existing interpretive guidance that, for purposes of this rule, the term has the meaning ascribed to it in Section 3(a)(11)¹⁶ of the Securities Exchange Act of 1934.¹⁷

Disclosure Requirements

NYSE Rule 472(k) sets forth a number of disclosure requirements for research reports and for public appearances by research analysts. In addition to disclosures relating to conflicts, this provision requires that a member organization disclose the meanings of ratings used in the member organization's rating system, the distribution of buy, hold, and sell ratings assigned by the member organization, and a price chart that plots the assignment or changes of the analyst's ratings and price targets for the subject company against the movement of the subject company's stock price over time. NYSE Rule 472.70 supplements this provision stating that the ratings disclosures be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter

¹⁵ See NYSE Information Memo 02-26.

¹⁶ 15 U.S.C. 78c(a)(11).

¹⁷ See NYSE Information Memo 02-26 and 04-10.

if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter).

The NYSE believes the proposed rule change to amend NYSE Rule 472 would clarify the existing requirement that the ratings distribution in a research report should reflect the current distribution of the most recent ratings that the member organization has issued for all subject companies, within the previous twelve (12) months.¹⁸

In addition, the proposed rule change would amend NYSE Rule 472(k)(1)(i)h to clarify that a price chart is required only if a research report contains either a rating or a price target, and the member organization has assigned a rating or price target to the subject company for at least one (1) year.¹⁹

The proposed rule change would also make certain non-substantive, technical changes to the disclosure requirements of NYSE Rule 472 in order to clarify that such disclosures are required only in certain research reports. Specifically, the proposed rule change would amend NYSE Rule 472 to clarify that: (1) a research report must disclose the meanings of ratings used in the member organization's ratings system only if the report contains a rating of the subject company's stock; (2) a research report must disclose the member organization's ratings distribution information only if the report contains a rating; and (3) a research report must disclose valuation methods used in determining price targets only if the report contains a price target.

Compendium Reports

NYSE Rule 472(k)(1)(iii)d provides that when a member organization distributes

¹⁸ See NYSE Information Memo 04-10.

¹⁹ See NYSE Information Memo 02-26.

a research report covering six or more companies, for purposes of the rule’s disclosure requirements, such report may direct the reader in a clear manner to the applicable current disclosures in written or electronic format.

The proposed rule change would codify the existing interpretation that an electronic compendium report – a research report covering six (6) or more subject companies – may include a hyperlink to the required disclosures. A paper-based compendium report must provide either a toll-free number to call or a postal address to write for the required disclosures and may also include a web address of the member organization where the disclosures can be found.²⁰

Third-party Research

First, the proposed rule change would add new paragraph (k)(4) (“Third-Party Research Reports”) to NYSE Rule 472 to codify existing interpretative guidance that when a member organization distributes research produced by another member organization, a non-member organization affiliate (e.g., a foreign broker-dealer or an investment adviser) or an independent third party, the member organization must disclose: (1) the member organization's and its affiliate's ownership of the subject company's securities, pursuant to NYSE Rule 472(k)(1)(i)c; (2) the member organization's and its affiliate's investment banking relationships with the subject company, pursuant to NYSE Rule 472(k)(1)(i)a; (3) the member organization's market making activities in the subject company's securities, pursuant to NYSE Rule 472(k)(1)(i)b; and (4) any other actual, material conflict of interest of the analyst or member organization, pursuant to NYSE Rule 472(k)(1)(iii)d (the “third-party

²⁰ See NYSE Information Memo 02-26.

disclosures”).²¹ Where a member organization distributes another member organization's research report, the distributing member organization must include the third-party disclosures as they pertain to the distributing member organization's relationship to the subject company, whereas the member organization whose report is being distributed is subject to all disclosure requirements under NYSE Rule 472.²²

Second, the proposed rule change clarifies that the third-party disclosures noted above shall not apply to research prepared by an independent third-party that the member organization makes available to its customers either upon request or through a member organization-maintained Web site. However, according to the NYSE, a member organization that makes a non-member organization affiliate's research report available to its customers upon request or through its website must include the third-party disclosures.

Third, the amendments set forth the review and approval requirements for third-party research distributed by a member organization. The amended rule provides that a supervisory analyst qualified under NYSE Rule 344 must approve, pursuant to NYSE Rule 472(a)(2), by signature or initial, any third-party research distributed by a member organization. In addition, a supervisory analyst or qualified person designated pursuant to NYSE Rule 342(b)(1) (e.g., a person who has taken and passed the Series 9/10, or another examination acceptable to the Exchange which demonstrates competency relevant to assigned responsibilities, including the Series 24 if taken and passed after July 1, 2001) must review third-party research distributed by a member organization to

²¹ See NYSE Information Memos 02-26 and 04-10.

²² See NYSE Information Memos 02-26 and 04-10.

determine that the third-party disclosures are complete and accurate, and that the content of the research report is consistent with all applicable standards regarding communications with the public.

The joint interpretive memoranda indicate that distribution of independent third-party research through a soft-dollar arrangement is not encompassed by the disclosure requirements. The proposed rule change would supersede this interpretation. Thus, when a member organization distributes independent third-party research through a soft-dollar arrangement, the third-party disclosure requirements would apply, unless another exception is available (e.g., where such research is provided upon customer request or furnished directly by the research provider to the customer).²³

Other Changes

In addition, changes are proposed to delete the term “member” as used in NYSE Rule 472 to reflect the recent reorganization of the Exchange.²⁴

The Exchange has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of the filing.

(2) NYSE’s Statutory Basis

The statutory basis for the proposed rule change is Section 6(b)(5)²⁵ of the Act 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

²³ A “soft-dollar” arrangement involves an agreement whereby a money manager receives research or brokerage services from a broker-dealer in exchange for brokerage commissions from transactions for clients’ accounts. In furnishing research, the broker-dealer may produce it in-house or obtain it from a third-party.

²⁴ See Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (order approving SR-NYSE-2005-77).

²⁵ 15 U.S.C. 78f(b)(5).

principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and national market system, and in general to protect investors and the public interest. The Exchange believes that the proposed rule change will enhance the clarity and consistency of the research analyst rules, thereby facilitating the goals of reducing conflicts of interest and fraudulent and manipulative practices, and providing investors with more objective, reliable information upon which to base investment decisions.

(3) NASD's Purpose

NASD Rule 2711 (Research Analysts and Research Reports) is intended to improve the objectivity of research and provide investors with important conflicts disclosures and other useful and reliable information with which to make investment decisions. Generally, NASD Rule 2711 restricts the relationship between research and investment banking; requires disclosure of financial interests in covered companies by the analyst and the firm; requires disclosure of existing and potential investment banking relationships with subject companies; imposes quiet periods for issuance of research reports; restricts personal trading by analysts; requires disclosure of information that helps investors track the correlation between an analyst's rating and the stock's price movements; requires that a compensation committee, without investment banking representation, review and approve compensation of research analysts; prohibits research analysts from participating in the solicitation of investment banking business; and prohibits research analysts from participating in road shows related to investment

banking transactions.

Since adoption of the rule in 2002,²⁶ NASD has jointly published with the New York Stock Exchange ("NYSE") two memoranda that provide interpretive guidance to members on a number of issues relating to the rule. See NASD Notice to Members 02-39 (July 2002) and NASD Notice to Members 04-18 (March 2004). On December 21, 2005, NASD and the NYSE submitted to the Commission a joint report on the operation and effectiveness of the SRO rules relating to research analyst conflicts of interest (the "SRO Report"). In connection with that report, NASD staff performed a detailed review of NASD Rule 2711 and recommended various rule changes, among them, codifying certain existing interpretations.²⁷

The proposed rule change would make express in NASD Rule 2711 a number of existing interpretations, most of which have previously been set forth in the two joint interpretive memoranda. Specifically, NASD is proposing to amend NASD Rule 2711 to make express in the rule language the interpretive guidance contained in Notice to Members 02-39 and Notice to Members 04-18 relating to (1) the definition of "equity security," (2) the definition of "investment banking services," (3) the definition of "member of a research analyst's household," (4) the definition of "public appearance," (5) the definition of "research report," (6) certain disclosure requirements, (7) compendium reports and (8) third-party research. In addition, NASD is proposing non-substantive,

²⁶ See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) (order approving SR-NASD-2002-021).

²⁷ The SRO Report also recommended a number of substantive rule changes that extend beyond codifying existing interpretations of the provisions of Rule 2711. Those changes are not included in this proposed rule change, but are the subject of a separate proposed rule change SR-NASD-2006-113, which has been filed contemporaneously herewith.

technical changes to NASD Rule 2711 where necessary to clarify the rule's intended meaning.

Definition of "equity security"

Currently, "equity security" is not defined in NASD Rule 2711. The proposed rule change would add "equity security" as a defined term in paragraph (a)(1) and would codify existing interpretive guidance that for purposes of this rule, the term has the meaning ascribed to it in Section 3(a)(11) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(11). See Notice to Members 02-39.

Definition of "investment banking services"

NASD Rule 2711(a)(2) defines "investment banking services" to include, 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 or similar investments; or serving as placement agent for the issuer.

The proposed rule change would renumber paragraph (a)(2) as paragraph (a)(3) in light of the rule change discussed above and would codify an existing interpretation that the definition of "investment banking services" also includes acting as a member of a selling group in a securities underwriting. See Notice to Members 02-39. Additionally, the proposed rule change would make a technical change to clarify that the acronym PIPE stands for "private investment, public equity transactions."

Definition of "member of a research analyst's household"

NASD Rule 2711(a)(3) defines a "member of a research analyst's household" as any individual whose principal residence is the same as the research analyst's principal residence.

The proposed rule change would renumber paragraph (a)(3) as paragraph (a)(4) in light of the rule change discussed above and would codify an existing interpretation that excludes from this definition any unrelated person who shares the same residence as a research analyst provided that the research analyst and unrelated person are financially independent of one another. Thus, according to NASD, for example, an analyst's roommate or apartment-mate, who is financially independent of the analyst, would not be considered a member of the analyst's household for purposes of the restrictions on personal trading and disclosure requirements in NASD Rule 2711. See Notice to Members 02-39.

Definition of "public appearance"

NASD Rule 2711(a)(4) defines "public appearance" as any participation in a seminar, forum (including an interactive electronic forum), radio, 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.

The proposed rule change would renumber paragraph (a)(4) as paragraph (a)(5) in light of the rule change discussed above and would codify several existing interpretations relating to the definition of "public appearance." First, NASD proposes to include conference calls in the definition. See Notice to Members 02-39.

Second, NASD proposes to amend the definition to expressly provide that only a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons constitutes a "public appearance." NASD believes this 15-person standard is consistent with SEC Regulation Analyst

Certification ("Regulation AC") and the proposed amendment to the definition of "research report" under NASD Rule 2711 (discussed below). See Notice to Members 04-18. As set forth in Notice to Members 04-18, the 15-person standard applies to separate investors. Thus, according to NASD, where a research analyst can ascertain at a public speaking activity before 15 or more individuals that those individuals represent fewer than 15 separate investors, then such activity would not constitute a "public appearance."

Third, the proposed rule change would amend the definition to provide that any conference call, seminar, forum or other public speaking activity before one or more representatives of the media constitutes a "public appearance" if the research analyst makes a recommendation or offers an opinion concerning an equity security. See Notice to Members 04-18. Thus, according to NASD, even if there are only five persons in attendance at a public speaking activity, if one of those persons is a representative of the media, the event will be a "public appearance." NASD believes this interpretation is consistent with the current definition, which expressly includes radio, television and print media interviews because the media are a conduit to the public.

Finally, NASD proposes to exclude from the definition password-protected Webcasts, conference calls and similar events with 15 or more existing customers (either individuals or entities), provided that the event participants have previously received the most current research report or other documentation that includes the disclosures required by NASD Rule 2711 and the research analyst appearing at the event corrects or updates during the public appearance any disclosures that are inaccurate, misleading or no longer applicable. See Notice to Members 04-18.

Definition of "research report"

NASD Rule 2711(a)(8) defines "research report" as a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

The proposed rule change would renumber paragraph (a)(8) as paragraph (a)(9) in light of the rule change discussed above and would codify an existing interpretation that communications that are limited to the following do not meet the definition of "research report": (1) discussions of broad-based indices, such as the Russell 2000 or S&P 500 index; (2) commentaries on economic, political or market conditions; (3) technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price; (4) statistical summaries of multiple companies' financial data, including listings of current ratings; (5) recommendations regarding increasing or decreasing holdings in particular industries or sectors; and (6) notices of ratings or price target changes, provided that the member simultaneously directs the readers of the notice to the most recent research report on the subject company that includes all current applicable disclosures required by NASD Rule 2711 and that such research report does not contain materially misleading disclosure, including disclosures that are outdated or no longer applicable. See Notice to Members 02-39.²⁸

²⁸ NASD believes that these exclusions essentially parallel those contained in SEC Regulation AC and the terms of the so-called "Global Settlement," an agreement among NASD, NYSE, the SEC, the North American Securities Administrators Association and ten of the largest investment banks to resolve allegations regarding biased research.

NASD notes that the proposed rule language to codify these interpretations is not identical to that in the joint memoranda. The changes reflect, in part, the fact that the definition of "research report" was subsequently amended and no longer requires a recommendation. Also, in some instances, NASD has chosen language more appropriate for rule text. In any event, unless

In addition, the proposed rule change would codify three exclusions from the definition of "research report" for certain communications, even if they include an analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision. First, NASD proposes to exclude any communication distributed to fewer than 15 persons. See Notice to Members 04-18.²⁹ This exclusion supersedes the interpretive guidance provided in Notice to Members 02-39 that an analysis prepared by a registered representative for a specific customer's account would not be considered a research report. Second, NASD proposes to exclude periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients that discuss individual securities in the context of a fund's or an account's past performance or the basis for previously made discretionary investment decisions. Thus, NASD believes that, for example, a manager's discussion of fund performance in a mutual fund shareholder report would not constitute a research report. See Notice to Members 04-18.³⁰ Third, NASD proposes to exclude from the definition internal communications that are not given to current or prospective customers. See Notice to Members 02-39.³¹

Additionally, the proposed rule change would codify an interpretation that communications that constitute statutory prospectuses that are filed as part of the registration statement are not considered "research reports," even if they meet the

otherwise noted, the substance of the existing interpretations are not intended to be different than those set forth in the joint memoranda.

²⁹ NASD believes that this exclusion parallels SEC Regulation AC.

³⁰ NASD believes that this exclusion parallels SEC Regulation AC.

³¹ NASD believes that this exclusion parallels SEC Regulation AC.

definitional elements. NASD believes prospectuses serve different purposes than research reports and are subject to a separate comprehensive regulatory scheme.

NASD is also proposing a non-substantive, technical change to the definition of "research report" to clarify that written communications include electronic communications. NASD believes that this change would be consistent with the definition of "research report" in SEC Regulation AC.

Disclosure Requirements

NASD Rule 2711(h) sets forth a number of disclosure requirements for research reports and public appearances by research analysts. In addition to disclosures relating to conflicts, this provision requires that a member disclose the meanings of ratings used in the member's rating system, the distribution of buy, hold, and sell ratings assigned by the member, and a price chart that plots the assignment or changes of the analyst's ratings and price targets for the subject company against the movement of the subject company's stock price over time.

The proposed rule change would amend NASD Rule 2711(h)(5) to codify the existing interpretation that the ratings distribution should reflect the current distribution of the most recent ratings that the member has issued for all subject companies, unless the most recent rating was issued more than 12 months ago. See Notice to Members 04-18. In addition, the proposed rule change would amend NASD Rule 2711(h)(6) to clarify that a price chart is required if a research report contains either a rating or a price target; however, a member is not required to provide a price chart if the research report does not include a rating or price target. See Notice to Members 04-18.

The proposed rule change would also make certain non-substantive, technical changes to the disclosure requirements of NASD Rule 2711(h) in order to clarify that such disclosures are required only in certain research reports. Specifically, NASD proposes to amend: (1) NASD Rule 2711(h)(4) to clarify that a research report must disclose the meanings of ratings used in the member's ratings system only if the report contains a rating of the subject company's stock; (2) NASD Rule 2711(h)(5) to clarify that a research report must disclose the member's ratings distribution information only if the report contains a rating; and (3) NASD Rule 2711(h)(7) to clarify that a research report must disclose valuation methods used in determining price targets only if the report contains a price target.

Compendium Reports

NASD Rule 2711(h)(11) provides that when a member distributes a research report covering six or more companies, for purposes of the rule's disclosure requirements, such report may direct the reader in a clear manner as to where the reader may obtain the applicable current disclosures in written or electronic format.

The proposed rule change would codify the existing interpretation that an electronic compendium report – a research report covering six or more subject companies – may include a hyperlink to the required disclosures. A paper-based compendium report must provide either a toll-free number to call or a postal address to write for the required disclosures and may also include a web address of the member where the disclosures can be found. See Notice to Members 02-39.

Third-party Research

The proposed rule change would add new paragraph (h)(13) to NASD Rule 2711 to codify the existing interpretive guidance relating to members' disclosure obligations in the context of distributing third-party research. Proposed new paragraph (h)(13)(A) would make express the existing interpretation that when a member distributes research produced by another member, a non-member affiliate (e.g., a foreign broker-dealer or an investment adviser) or an independent third party, the member must disclose (1) the member's and its affiliate's ownership of the subject company's securities, pursuant to NASD Rule 2711(h)(1)(B); (2) the member's and its affiliate's investment banking relationships with the subject company, pursuant to NASD Rule 2711(h)(2)(A)(ii); (3) the member's market making activities in the subject company's securities, pursuant to NASD Rule 2711(h)(8); and (4) any other actual, material conflict of interest of the analyst or member, pursuant to NASD Rule 2711(h)(1)(C) (the "third-party disclosures"). Thus, according to NASD, when a member distributes another member's research report, the distributing member must include the third-party disclosures as pertains to the distributing member's relationship to the subject company, while the member whose report is being distributed must comply with all of the disclosure requirements under NASD Rule 2711. See Notice to Members 02-39 and Notice to Members 04-18.³²

The joint interpretive memoranda indicate that distribution of independent third-party research through a soft-dollar arrangement is not encompassed by the disclosure requirements. According to NASD, the proposed rule change would supersede this interpretation. Thus, NASD believes that when a member distributes independent third-party research through a soft-dollar arrangement, the third-party disclosure requirements

³² New paragraph (h)(13) and existing paragraphs (h)(1)(C), (h)(2)(A)(ii) and (h)(8) of NASD Rule 2711 will be renumbered pursuant to related rule filing SR-NASD-2006-113, discussed herein at note 27.

would apply, unless another exception is available (e.g., where such research is provided upon customer request).

The proposed rule change would codify the existing interpretation that a member is not required to make the third-party disclosures when the member makes independent third-party research reports available to its customers upon request or through a member-maintained web site. See Notice to Members 02-39 and Notice to Members 04-18.

However, a member that makes a non-member affiliate's research report available to its customers upon request or through its web site must include the third-party disclosures. See Notice to Members 04-18.

Finally, NASD believes that consistent with the requirements of NASD Rule 2210(b)(1), the proposed rule change would clarify that a registered principal must approve by signature or initial any third-party research distributed by a member. This requirement may be met by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange (i.e., a Series 16 Supervisory Analyst). All third-party research distributed by a member must be reviewed by the designated principal (or Series 16 Supervisory Analyst, as the case may be) to determine that the applicable disclosures required by NASD Rule 2711 are complete and accurate, and the content of the research report is consistent with all applicable standards regarding communications with the public.

With respect to research reports prepared by a member, NASD reminds members that the content of the research report must be approved by an individual who has passed either (1) the Series 24 and the Series 87 or (2) the Series 16. If the member elects to have a Series 16 approve the content of research, then a Series 24 principal who has also

passed either the Series 87 or the Series 16 must supervise the conduct of both the Series 16 Supervisory Analyst and the research analyst. See NASD Rule 1022(a)(5) and NASD Notice to Members 04-81 (November 2004). Similar to the approach set forth above regarding the approval of third-party research, NASD will permit any registered principal or a Series 16 Supervisory Analyst to supervise for compliance with the disclosure provisions (only) of NASD Rule 2711. According to NASD, all other content of the research report must continue to be approved by an individual who has passed either the Series 24 and the Series 87, or the Series 16. NASD reminds members that in accordance with NASD Rule 3010 (Supervision), all personnel reviewing both member and third-party research must be qualified by virtue of experience and training to carry out such review.

NASD has filed the proposed rule change for immediate effectiveness. The effective date and the implementation date will be the date of filing, September 27, 2006.

(4) NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,³³ which requires, among other things, that NASD 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. NASD believes that the proposed rule change will enhance the clarity and consistency of the research analyst rules, thereby facilitating the goals of reducing conflicts of interest and fraudulent and manipulative practices, and providing investors with more objective, reliable information upon which to base investment decisions.

³³ 15 U.S.C. 78o-3(b)(6).

B. Self-Regulatory Organizations' Statements on Burden on Competition

The 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 Act, as amended.

C. Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Changes Received from Members, Participants, or Others

The NYSE and NASD have neither solicited nor received written comments.

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

The foregoing rule changes have become effective pursuant to Section 19(b)(3)(A) of the Act³⁴ and paragraph (f)(1) of Rule 19b-4 thereunder,³⁵ in that the proposed rule changes constitute a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within 60 days of the filing of the proposed rule changes, the Commission may summarily abrogate such rule changes 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

³⁴ 15 U.S.C. 78s(b)(3)(A).

³⁵ 17 CFR 240.19b4-4(f)(1).

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Numbers SR-NYSE-2006-77 and/or SR-NASD-2006-112 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Numbers SR-NYSE-2006-77 and/or SR-NASD-2006-112. These file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and

copying at the principal offices of the NYSE and NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Numbers SR-NYSE-2006-77 and/or SR-NASD-2006-112 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁶

Nancy M. Morris
Secretary

³⁶ 17 CFR 200.30-3(a)(12).