

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34 - 51358; File Nos. SR-NYSE-2004-24; SR-NASD 2004-141)

March 10, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Changes by the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. to Prohibit Participation by a Research Analyst in a Road Show Related to an Investment Banking Services Transaction and to Require Certain Communications About an Investment Banking Services Transaction to be Fair, Balanced and Not Misleading

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 April 22, 2004 the New York Stock Exchange (“NYSE” or the “Exchange”), and on September 20, 2004, 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 (“SROs”). On February 11, 2005, NYSE filed Amendment No. 1 to its proposed rule change, which replaced the original rule filing in its entirety. On February 4, 2005, NASD filed Amendment No. 1 to its proposed rule change, which replaced the original rule filing in its entirety.³ The Commission is publishing this notice to solicit comments on the proposed rule changes, as amended, from interested persons.

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

The Exchange is filing with the Commission a proposed amendment to NYSE Rule 472 (“Communications with the Public”) which, among other things, will prohibit

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On March 9, 2005, NASD filed with the Commission Amendment No. 2 to its proposed rule change, which clarified that Amendment No. 1 replaced the original filing in its entirety.

research analysts from participating in road shows relating to investment banking services transactions.

NASD is proposing a rule change to NASD Rule 2711 to prohibit (1) a research analyst from participating in a road show related to an investment banking services transaction, or otherwise communicating with customers in the presence of investment banking personnel or company management about an investment banking services transaction and (2) investment banking personnel from directing a research analyst to engage in sales and marketing efforts or other communications with a current or prospective customer related to an investment banking services transaction. The proposed rule change would permit analysts to educate investors and internal personnel about an investment banking services transaction, provided such communications are fair, balanced and not misleading. Amendment No. 1 to the proposed rule change makes express in the rule language the requirement that those communications be fair and balanced.

Below is the text of the proposed rule changes. Proposed new language is italicized.

A. NYSE's Proposed Rule Text

Rule 472 Communications with the Public

Approval of Communications and Research Reports

(a)(1) – (b)(5) – No change.

Investment Banking, Research Department and Subject Company Relationships and Communications

(b)(6)(i) A research analyst is prohibited from directly or indirectly:

(a) participating in a road show related to an investment banking services transaction; and

(b) engaging in any communication with a current or prospective customer(s) in the presence of investment banking department personnel or company management about an investment banking services transaction.

(ii) Investment banking department personnel are prohibited from directly or indirectly:

(a) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and

(b) directing a research analyst to engage in any communication with a current or prospective customer(s) about an investment banking services transaction.

(iii) Research analyst written and oral communications relating to an investment banking services transaction, with a current or prospective customer(s), or with internal personnel, must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

(c) – .120 – No change.

B. NASD's Proposed Rule Text

Rule 2711. Research Analysts and Research Report

(a) through (b) No change.

(c) Restrictions on Communications with the Subject Company

(1) through (4) No change.

(5) A research analyst is prohibited from directly or indirectly:

(A) participating in a road show related to an investment banking services transaction; and

(B) engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

(6) Investment banking department personnel are prohibited from directly or indirectly:

(A) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and

(B) directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction.

(7) Any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

(d) through (k) No change.

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

In their filings with the Commission, the Exchange and NASD included statements concerning the purpose of, and basis for, the proposed rule changes, as amended, and discussed any comments received on the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

The Exchange is proposing an amendment to NYSE Rule 472, which, among other things, would prohibit research analysts from participating in road shows relating to investment banking services⁴ transactions.

Background

Joint regulatory efforts among the NYSE, NASD (the “SROs”) and the SEC to address potential conflicts of interest relating to research analysts resulted in: (1) SEC approval of major SRO rule changes in May 2002;⁵ (2) the adoption of the Commission’s Regulation Analyst Certification (“Regulation AC”),⁶ which requires research analysts to certify that their research reports accurately reflect their personal views and disclose whether they received compensation for their specific recommendations; (3) the Global Research Analyst Settlement (“Global Settlement”) reached between various securities regulators and 10 major investment banking firms to conclude enforcement actions regarding research analysts’ conflicts of interest;⁷ and (4) additional changes to the SRO

⁴ As defined under Rule 472.20, “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. The term also includes acting as a member of a selling group in a securities underwriting (See NYSE Information Memo No. 02-26, dated June 26, 2002).

⁵ See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34969 (May 16, 2002) (SR-NYSE-2002-09).

⁶ 17 CFR 242.501.

⁷ See SEC Litigation Release No. 18438 (October 31, 2003).

Rules to conform to the Sarbanes-Oxley Act,⁸ which were approved by the SEC in July 2003⁹ (the “Sarbanes-Oxley Amendments”).

Currently, according to the NYSE, NYSE Rules 472 and 351 generally restrict the relationship between research and investment banking departments and the companies that are the subjects of research reports; require disclosure of financial interests in subject companies by analysts or members or member organizations; require disclosure of client relationships with and compensation from subject companies; impose quiet periods for the issuance of research reports following the completion of companies’ securities offerings; restrict personal trading by research analysts in the securities of the companies covered by such analysts; require attestations by members and member organizations that they are in compliance with NYSE Rule 472; and generally require extensive disclosure in research reports of certain important information to help customers monitor the correlation between research analysts’ ratings and the price movements of subject companies’ securities.

The Global Settlement

As noted above, the SEC, NYSE, NASD, NASAA and the New York Attorney General’s Office announced in 2003 a global settlement with 10 investment banking firms to settle enforcement actions involving conflicts of interest between research and investment banking. The NYSE notes that, among the undertakings included in the settlement is a prohibition against research analysts participating in efforts to solicit investment-banking business, including attending “pitch” meetings. According to the

⁸ 15 U.S.C. 78o-6.

⁹ See Securities Exchange Act Release No. 48252 (July 29, 2003), 68 FR 45875 (August 4, 2003) (SR-NYSE-2002-49).

NYSE, these restrictions were imposed to prevent stock recommendations from being tainted by efforts to obtain investment banking fees, and to further remove research analysts from investment banking pressures.

In July 2003, the SEC approved the Sarbanes-Oxley Amendments. At the same time, the SEC also approved NYSE Rule 472(b)(5), which prohibits research analysts from participating in solicitation activities (e.g., pitch meetings) to secure investment banking business from companies. During the filing and public comment period, the SEC requested comment on the SRO proposed amendments in light of the Global Settlement, and also noted that although certain elements of the Global Settlement were addressed by the SROs in their proposed amendments (e.g., pitch meeting prohibitions), there were differences as well.

Proposed Amendment

Proposed NYSE Rule 472(b)(6) provides that:

- (i) A research analyst is prohibited from directly or indirectly:
 - (b) participating in a road show related to an investment banking services transaction; and
 - (c) engaging in any communication with a current or prospective customer(s) in the presence of investment banking department personnel or company management about an investment banking services transaction.
- (ii) Investment banking department personnel are prohibited from directly or indirectly:

- (a) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and
 - (b) directing a research analyst to engage in any communication with a current or prospective customer(s) about an investment banking services transaction.
- (iii) Research analyst written and oral communications relating to an investment banking services transaction, with a current or prospective customer(s), or with internal personnel, must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

Discussion

The NYSE believes that underwriters are the crucial intermediaries in the process of offering securities to the public. According to the NYSE, they provide sales and marketing expertise to issuers during the securities offering process, and provide research coverage for companies they help bring public. The NYSE believes that since research can impact the price of a company's securities, it is paramount to investor protection, that such research be objective, unbiased, and not the result of pressure on an analyst. The NYSE notes that such pressure can take the form of: trying to reward a company for its investment banking business, or to assist a firm's investment bankers in obtaining and maintaining investment banking relationships with a company. The NYSE believes that to ensure this goal, it is necessary to insulate research analysts from these pressures.

According to the NYSE, the offering of securities is divided into three time periods: (1) pre-filing, (2) waiting, and (3) the post-effective period. Once a company

contemplates a public offering, the time period preceding the filing of the registration statement is known as the pre-filing period. After the filing of the registration statement with the Commission, there is a statutory waiting period prior to the effective date of the registration statement. After the effective date, sales of the securities can take place.¹⁰ It is during this waiting period that underwriters, with the management of issuers, conduct road shows for the purpose of marketing the offering. Finally, there is the post-effective period that continues until the distribution of securities has been completed. It is during this period that prospectus delivery requirements are imposed, and restrictions on the issuance of research reports, often referred to as “quiet periods” occur.¹¹

According to the NYSE, regulatory investigations and examinations revealed that research analysts were subject to conflicts of interest when their firms were offering investment banking services to, and maintaining investment banking relationships with, corporate issuers. In this regard, the NYSE notes that the investigations found that investment banking firms may have promised favorable research, specific research ratings, or price targets as consideration or inducement for the receipt of investment banking business. Furthermore, the NYSE believes that investment bankers and companies reviewed research reports prior to their publication, which often pressured

¹⁰ 15 U.S.C. 77(h)a.

¹¹ After the effective date of the offering, Section 2(a)(10) of the Securities Act of 1933 (the “Securities Act”) (15 U.S.C. 77b(a)(10)) permits the use of supplementary sales literature (i.e. research reports) even if such literature does not conform to or is contained in a statutory prospectus, meeting the requirements of Section 10 of the Securities Act (15 U.S.C. 77j). The use of this supplementary sales literature, or “free writing,” is limited in that prior to or at the same time of receiving it, a person must have received a Section 10(a) statutory prospectus. Given this limitation, firms often wait until this prospectus delivery requirement ceases before issuing research reports.

research analysts to write more favorable reports on such companies than an objective, unbiased analysis of the company warranted.

According to the NYSE, it was in response to this activity that the Exchange and NASD promulgated the rules noted above to address these concerns. These rules expressly prohibit members and member organizations from offering favorable research, ratings or price targets as consideration or inducement for the receipt of investment banking business.¹² In addition, the NYSE notes that rules were promulgated to prevent research analysts from being pressured to provide favorable reports and ratings, such as prohibiting investment banking personnel from exercising supervision, control and compensatory evaluation over research analysts,¹³ and prohibiting pre-publication review and approval of research reports by investment banking personnel and the companies that are the subjects of such reports.¹⁴

The NYSE notes that the rules also prohibit research analysts from participating in pitch meetings with prospective investment banking clients.¹⁵ According to the NYSE, the purpose of this prohibition is to prevent the use of research as a sales and marketing tool, or to influence prospective clients.

Further, the Exchange promulgated restrictions on the publication and/or distribution of research reports by managers, co-managers, underwriters and dealers

¹² See NYSE Rule 472(g)(1).

¹³ See NYSE Rule 472(b)(1).

¹⁴ See NYSE Rules 472(b)(2) and (4).

¹⁵ See NYSE Rule 472(b)(5).

following initial public¹⁶ and secondary offerings¹⁷ by issuers and the expiration and/or waiver of lock-up agreements made in connection with such offerings.¹⁸ According to the NYSE, the purpose of these quiet period restrictions was to minimize the ability of firms to reward issuers for giving them investment banking business by publishing favorable research soon after the completion of offerings.

As noted above, the Exchange believes it has already adopted rules to address inherent conflicts of interest that arise when research analysts are used by their firms to obtain, during the waiting period, and reward, during the post-effective period, issuers for their investment banking business. According to the NYSE, the proposed prohibition on research analyst participation in road shows seeks to address potential conflicts of interest during the periods that firms market securities offerings for issuers. As proposed, the NYSE believes that the new rule should insulate research analysts from potential undue influence of investment bankers and company management, but not interfere with legitimate activities.

By prohibiting analysts from engaging in any communication regarding investment banking services with current or prospective customers in the presence of investment banking personnel or company management, the Exchange believes it will reduce the pressure on research analysts to give overly optimistic assessments of

¹⁶ As defined under Rule 472.100, an “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 (the “Exchange Act”) (15 U.S.C. 78a), prior to the time of the filing of such issuer’s registration statement.

¹⁷ As defined under Rule 472.110, 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 under the Exchange Act.

¹⁸ See NYSE Rules 472(f)(1), (2), (3) and (4).

investment banking services transactions. The NYSE believes that research analysts would still be able to communicate with customers in circumstances where investment banking and company management cannot influence analysts' truthful assessments of investment banking services transactions.

The Exchange is also proposing that investment banking department personnel be prohibited from directing research analysts to: (1) engage in sales or marketing efforts related to investment banking services transactions; and (2) engage in communications with current or prospective customers about investment banking services transactions.

According to the NYSE, the proposed rule preserves the traditional function of research analysts (providing analysis of securities and transactions), while placing further limitations on the ability of investment banking personnel to influence and/or compromise the objectivity of their analysis.

While the proposed rule recognizes that road shows are a common form of investment banking "sales or marketing efforts" from which research analysts should be barred, the Exchange recognizes there are certain activities that do not compromise the objectivity and independence of research analysts. Therefore, the NYSE believes that the proposed rule change would permit research analysts to issue written and oral communications relating to investment banking services transactions to current or prospective customers or internal personnel. According to the NYSE, such communications to investors and employees must be fair, balanced, and not misleading, while taking into consideration the overall context in which such communications are made.

The Exchange also notes that the proposed prohibition on research analysts' participation in road shows would not prohibit certain analysts' communications that are permitted under the federal securities laws (i.e. research reports issued in accordance with Rules 137, 138 and 139 under the Securities Act).¹⁹

The Exchange notes that, although the proposed amendment incorporates, to some extent, the substance of the comparable sales or marketing prohibitions found in the "Global Settlement," the Exchange is not filing the proposed rule change simply to conform to the Global Settlement, or to address the differences between the Global Settlement and NYSE rules. The Exchange believes the proposed amendment facilitates objective, independent, and reliable research by prohibiting research analysts employed by all members and member organizations from participating in road shows. The Exchange expects the entire securities industry and not just the signatory firms to the Global Settlement to benefit from this prohibition. The NYSE believes that by further insulating research analysts from the pressures associated with obtaining and maintaining investment banking relationships, the proposed rule change will engender more objective and unbiased research on companies who are the investment banking clients of members and member organizations.

Effective Date

The Exchange believes that the proposed amendment to NYSE Rule 472 should take effect 45 days after SEC approval. As proposed, the Exchange believes that the amendment does not impose any new or substantive requirements on members and member organizations nor would it necessitate the adoption of new systems and

¹⁹ 17 CFR. 230.137, 230.138 and 230.139.

procedures to ensure compliance. Accordingly, the NYSE believes that 45 days is sufficient notice for firms to comply with the new prohibition.

2. NYSE's Statutory Basis

The NYSE believes the statutory basis for this proposed rule change is Section 6(b)(5)²⁰ of the Exchange Act which requires, among other things, that the rules of the Exchange 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 interests. The NYSE believes that, by prohibiting research analysts from participating in road shows, the potential for conflicts of interests that could bias their research reports will be mitigated and thus serve the investing public by providing more objective research on subject companies.

3. NASD's Purpose

Over the past few years, NASD has worked with the SEC and New York Stock Exchange (NYSE) to implement a series of rules to increase the objectivity and reliability of research. NASD believes that while the rules generally foster objectivity through extensive conflict of interest disclosure requirements, they also prohibit certain conduct to minimize the primary source of biased research: the influences of investment banking. To that end, NASD Rule 2711 prohibits compensation paid to analysts based on their contributions to, or the success of, the investment banking department. The rule further prohibits analysts from participating in efforts to solicit investment banking business, including "pitches" to earn an underwriting mandate for a securities offering.

According to the NASD, the proposed rule change would further fortify the wall between investment banking and research by prohibiting research analysts from

²⁰ 15 U.S.C. 78f(b)(5).

participating in a road show related to an investment banking services transaction and from communicating with current or prospective customers in the presence of investment banking department personnel or company management about such an investment banking services transaction. Additionally, the proposed rule change would prohibit investment banking personnel from directing a research analyst to engage in sales and marketing efforts and other communications with a current or prospective customer about an investment banking services transaction.

NASD believes that the primary role of a research analyst is to provide unbiased analysis of companies and transactions and to value securities accurately. NASD further believes that the objectivity and reliability of such analysis can be compromised when a research analyst is utilized to market those same transactions and the sale of such securities. Accordingly, by prohibiting research analyst participation in road shows, the proposed rule change will further reduce the pressure on research analysts to give an overly optimistic assessment of a particular transaction. NASD believes it further will remove any suggestion to investors in attendance that the analyst will give positive coverage to the issuer and that the analyst endorses all of the views expressed by the company or investment banking department personnel.

According to the NASD, the proposed rule change would, however, permit research analysts to educate investors and member personnel about a particular offering or other transaction, provided the communication occurs outside the presence of the company or investment banking department personnel. NASD believes that such permissible communications to investors and internal personnel must be fair, balanced and not misleading, taking into account the overall context in which such

communications are made. Thus, NASD believes that the proposed rule change preserves the ability of the research analyst to give a candid assessment of a transaction or sale of securities – including investment risks – in settings where the influences of investment banking and client pressure are minimized.

Finally, the proposed rule change would prohibit investment banking department personnel from directing a research analyst to engage in sales or marketing efforts and any other communication with a current or prospective customer about an investment banking services transaction. NASD believes this provision is important to eliminate any attempt by investment banking personnel to pressure a research analyst to engage in those communications, thereby further insulating research analysts from influences that could affect their objectivity.

NASD specifically requests comment on whether the proposed prohibitions should extend to supervisors of research analysts, directors of the research department or others who have the ability to influence the substance of research reports.

NASD also notes that the settlement of research analyst conflicts allegations among NASD, NYSE, the SEC, state regulators and twelve of the nation's largest investment banking firms ("Global Settlement") contains a prohibition similar to the proposed rule change. NASD does not believe that consistency with the Global Settlement is itself a rationale for the proposed rule change. However, in this instance, NASD believes that the similar proposed rule change will facilitate the goal of more objective and reliable research by all members, with the ancillary benefit of rules consistency.

The effective date of the proposed rule change will be 45 days following Commission approval.

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,²¹ 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 is consistent with the provisions of the Act because it will reduce conflicts of interest and thereby provide investors with more reliable information and also curtail the potential for fraudulent and manipulative acts.

(B) Self-Regulatory Organizations' Statement on Burden on Competition

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

(C) Self-Regulatory Organizations' Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The NYSE and NASD have neither solicited nor received written comments on the proposed rule changes.

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

²¹ 15 U.S.C. 78o-3(b)(6).

if it finds such longer period to be appropriate and publishes its reasons for so finding, or
(ii) as to which the NYSE and NASD consents, the Commission:

- (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

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is 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-2004-24 and/or SR-NASD-2004-141 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Numbers SR-NYSE-2004-24 and/or SR-NASD-2004-141. This file number 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 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office 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-2004-24 and/or SR-NASD-2004-141 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.²²

J. Lynn Taylor
Assistant Secretary

²² 17 CFR 200.30-3(a)(12).