

an unfavorable research report or the making of such an unfavorable public appearance.

(k) Exemption for Small Firms

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both debt and equity securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

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 statutory 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 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 recently adopted sweeping and dramatic rule changes governing the manner in which members and member organizations, their investment banking departments and associated persons (hereinafter referred to as research analysts) manage and disclose conflicts of interest between their investment-banking and research departments. According to NYSE, these amendments were precipitated by a series of events that had eroded investor confidence in the equities markets and called into question the ways in which these conflicts of interest were managed and disclosed to the investing public. According to the NYSE, the additional amendments, pending approval of the SEC and new proposed changes discussed below, were developed by the Exchange in collaboration with the NASD under the guidance of the SEC.

The Exchange believes that the amendments to the NYSE rules proposed in this filing are necessary in order to comply with the mandates of the SOA, which amends the Exchange Act⁷ by adding new section 15D⁸ which requires the SEC, "or upon authorization and direction of the Commission, a self-regulatory organization," to adopt not later than one year after July 30, 2002, the date of enactment of the SOA, "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."⁹

The Exchange believes that certain of the disclosure requirements and prohibitions that the SOA mandates have already been adopted in new NYSE Rules. The Exchange believes that the SOA appears to impose different, and in some instances more stringent, requirements than current NYSE Rule 472. According to NYSE, given the complexity and possible ramifications of the changes necessitated by the SOA, the SROs in conjunction with the SEC, spent considerable time examining which aspects of the SRO rules would require further amendments. Accordingly, proposed conforming SOA changes are being made in two phases. In the Original Notice, the Exchange proposed an amendment, discussed below, to the definition of the term "research report" contained in NYSE Rule 472.10(2), to conform to the requirements of section 15D(c)(2) of the Exchange Act.¹⁰ The Exchange also proposed an amendment, discussed below, that it believes would satisfy the requirements of section 15D(a)(1)(B) of the Exchange Act by limiting the "compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities."¹¹ These proposed amendments are pending with the Commission. According to NYSE, as discussed in more detail below, the Exchange is currently proposing further amendments to its rules in order to conform to the requirements of the SOA.

February 2002 Filing

In February 2002, the Exchange filed with the Commission proposed amendments to Exchange Rules 472 and

351, which were approved by the Commission in May 2002.¹² In the May 10th Order, the SEC also simultaneously approved comparable changes to NASD rules (new NASD Rule 2711—"Research Analysts and Research Reports").

The rule amendments generally: restrict the relationship between research and investment banking departments and the companies that are the subjects 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 securities 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 a research analyst's ratings and the price movements of subject companies' securities.

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 SRO rules began July 9, 2002, with September 9, 2002 and November 6, 2002 as the effective dates for certain specified provisions.

According to NYSE, as a result of comments received, the SEC approved, on a temporary basis, NYSE rule proposals providing for an exemption from the gatekeeper provisions (NYSE Rules 472(b)(1), (2), and (3)) for members and member organizations that over the three previous years, on average per year, have participated in ten or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions (hereinafter referred to as "small firms").¹³ As discussed in more detail below, the NYSE is proposing that certain elements of the temporary small firm exemption to the gatekeeper provisions be made permanent. During

¹² See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34969 (May 16, 2002) ("May 10th Order").

¹³ See Securities Exchange Act Release No. 46182 (July 11, 2002), 67 FR 47013 (July 17, 2002); Securities Exchange Act Release No. 46949 (December 4, 2002), 67 FR 76202 (December 11, 2002).

⁷ 15 U.S.C. 78a et seq.

⁸ 15 U.S.C. 78o-6.

⁹ Id. at (a).

¹⁰ 15 U.S.C. 78o-6 (c)(2).

¹¹ 15 U.S.C. 78o-6(a)(1)(B).