

personnel and the research department be intermediated by legal or compliance staff.

Quiet Periods

Section 15D(a)(2)³⁸ of the Exchange Act requires establishment of periods during which brokers or dealers who have participated or are to participate in a public securities offering as underwriters or dealers may not publish or otherwise distribute research reports related to the issuer of the offering. NASD Rule 2711(f) currently imposes such quiet periods—for 40 calendar days following an initial public offering and 10 calendar days following a secondary offering—on underwriting managers and co-managers, but not on other members of the underwriting syndicate or selling group. According to NASD, to comply with the SOA, NASD Amendment No. 2 would establish a 25-day period after the “date of the offering” during which an underwriter or dealer other than a manager or co-manager would be prohibited from publishing or distributing research on the issuing company’s securities. This 25-day prohibition effectively codifies a *de facto* quiet period that exists because of the prospectus delivery requirements under Rule 174 under the Securities Act.³⁹ In general, brokers or dealers refrain from issuing research on exchange-listed or National Market System securities for 25 days after a registration statement becomes effective or bona fide public trading begins to avoid the risk that such communications may be deemed prospectuses that do not meet the requirements of section 10 of the Securities Act.⁴⁰

NASD Amendment No. 2 also would define “date of the offering” for all quiet period provisions to mean the later of the effective date of the registration statement or the first date on which the security was bona fide offered to public.

Prohibition of Retaliation Against Research Analysts

Section 15D(a)(1)(C)⁴¹ of the Exchange Act prohibits a broker or dealer engaged in investment banking activities from directly or indirectly retaliating, or threatening to retaliate, against a research analyst who publishes a research report that may adversely affect a member’s present or prospective investment banking relationship. NASD Amendment No. 2 creates new NASD Rule 2711(j) to implement this directive

and extends the prohibition to public appearances. The proposed rule incorporates language in SOA that clarifies that the prohibition does not limit a member’s authority to discipline a research analyst, in accordance with the member’s policies and procedures, for any cause other than writing a research report or the making of a public appearance that is unfavorable to a current or potential investment banking relationship. NASD has further clarified in the proposal that the anti-retaliation provision would not preclude termination, in accordance with firm policies and procedures, for causes unrelated to issuing or distributing such adverse research or for making an unfavorable public appearance regarding a current or potential investment banking relationship.

Receipt of Compensation and Disclosure of Client Relationships

Section 15D(b)(2)⁴² of the Exchange Act requires disclosure by a broker or dealer in research reports, and by a research analyst in public appearances, if any compensation has been received by the broker or dealer, or any affiliate thereof (including the analyst), from the issuer that is the subject of the report or public appearance. Section 15D(b)(3)⁴³ of the Exchange Act further requires disclosure if the subject issuer is, or has been during the previous year, a client of the broker dealer, and if so, the types of services provided to the issuer. Section 15D(b)(2)⁴⁴ of the Exchange Act is subject to exemptions as the Commission may determine appropriate and necessary to prevent disclosure of material non-public information regarding specific potential future investment banking transactions of the issuer.⁴⁵

According to NASD, these mandates necessitate several changes to current NASD Rule 2711. First, NASD Rule 2711 currently requires disclosure only of investment banking compensation received from a subject company or its affiliates in the past 12 months. Accordingly, NASD Amendment No. 2 would expand the required disclosure to cover any compensation received by a member or its affiliates from the subject company. While the SOA does not

specify a look-back period, NASD has established a 12-month retrospective period to be consistent with existing NASD Rule 2711 and section 15D(b)(3)⁴⁶ of the Exchange Act, which imposes the same timeframe for disclosure of a client relationship with the subject company.

NASD Amendment No. 2 would require separate disclosure of investment banking compensation and other, non-investment banking compensation received from the subject company or its affiliates. NASD believes this approach will result in more meaningful disclosure by separating out investment banking compensation, which NASD believes generally is the primary influence on research objectivity. Absent the separate disclosure, investors might not learn whether disclosure of compensation received by the member from the subject company came from lucrative investment banking services or less remunerative and influential business lines. NASD specifically requests comment on whether a *de minimis* exemption would be appropriate for this provision, and if so, at what dollar level such exemption should be set.

Second, NASD Rule 2711 currently does not expressly require disclosure of compensation received by a research analyst from a subject company. To the extent that receipt of such compensation constitutes an actual, material conflict of interest, disclosure would be required under NASD Rule 2711(h)(1)(C). Nonetheless, NASD is amending NASD Rule 2711 to require disclosure of any compensation received by an analyst from the subject company in the past 12 months.

Third, NASD is amending NASD Rule 2711 to add a provision that requires a research analyst to disclose in public appearances if the member or any of its affiliates received any compensation from the subject company within the past 12 months. A research analyst must only disclose this fact if the analyst knows or has reason to know it to be the case.

Fourth, NASD is amending NASD Rule 2711 to require disclosure in research reports and public appearances if the subject company is, or has been over the preceding 12 months, a client of the member. If this disclosure is applicable, the member (in research reports) or the research analyst in public appearances (if the research analyst knows or has reason to know) must also disclose the types of client services provided to the subject company. These services may be described as falling into

³⁸ 15 U.S.C. 78o-6(a)(2).

³⁹ 17 CFR 230.174.

⁴⁰ 15 U.S.C. 77j.

⁴¹ 15 U.S.C. 78o-6(a)(1)(C).

⁴² 15 U.S.C. 78o-6(b)(2).

⁴³ 15 U.S.C. 78o-6(b)(3).

⁴⁴ 15 U.S.C. 78o-6(b)(2).

⁴⁵ The exemptive language of the SOA appears only in section 15D(b)(2) of the Exchange Act (15 U.S.C. 78o-6(b)(2)). However, NASD and the staff of the Exchange believe that the exemption must be interpreted to apply to certain other disclosure requirements that could tip material non-public information regarding a specific potential future investment banking transaction or else the purpose of the exemption would be frustrated.

⁴⁶ 15 U.S.C. 78o-6(b)(3).