

one of the following three categories: (1) Investment banking services, (2) non-investment banking securities-related services, or (3) non-securities services.

#### *Small Firm Exemption*

NASD Amendment No. 2 also would create new NASD Rule 2711(k), an exemption from NASD Rule 2711(b) for certain firms that engage in limited underwriting activity. NASD Rule 2711(b) prohibits a research analyst from being subject to the supervision or control of any employee of a member's investment banking department and further requires legal or compliance personnel to intermediate certain communications between the research department and the investment banking department.

As the Commission noted in the May 10th Order, several commenters argued that the gatekeeper provisions of NASD Rules 2711(b) and (c) would impose significant costs, especially for smaller firms that would have to hire additional personnel. Commenters also noted that personnel often wear multiple hats in smaller firms, thereby causing a greater burden to comply with the restriction on supervision and control by investment banking personnel over research analysts. These comments raised the prospect that the rules might force some firms out of business or reduce important sources of capital and research coverage for smaller companies and companies of regional or local interest.

To temporarily address those concerns while it considered an appropriate exemption, NASD delayed effectiveness of NASD Rules 2711(b) and (c) until July 30, 2003, or until a superseding permanent exemption is approved by the SEC and becomes effective, for those members that over the previous three years, on average per year, have participated in 10 or fewer investment banking transactions or underwritings as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions.<sup>47</sup> NASD Amendment No. 2 would create a permanent exemption from NASD Rule 2711(b) for those members that meet the same eligibility requirements as was required for the temporary exemption. NASD is not proposing to exempt these members from NASD Rule 2711(c), which restricts communications between the research department and the issuer, because NASD believes those

communications do not result in the same burdens as NASD Rule 2711(b).

NASD Amendment No. 2 also would require members that qualify for this exemption to maintain records for three years of any communication that otherwise would be subject to the review and monitoring provisions of NASD Rule 2711(b)(3).

#### *Other Changes*

NASD Amendment No. 2 also would conform certain existing rule language with that used in the SOA. For example, the term "publish or otherwise distribute" has been substituted in place of references to research reports that are "issued" or "published." The amendment also would make a few other non-substantive language changes.

#### *Effective Dates*

NASD suggests the following effective dates for the new provisions contained in SR-NASD-2002-154 and this Amendment thereto:

- NASD Rule 1050—Registration of Research Analysts: such time as announced in a *Notice to Members* after SEC approval of the rule change, but not less than 180 days from such approval
- NASD Rule 1120(a)(5) and (b)(1)—Regulatory and Firm Elements: Not less than 180 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(C)—Disclosure of Non-Investment Banking Compensation: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(E)—Disclosure in Public Appearances of Compensation Received from Issuer and Affiliates: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(F)—Disclosure of Client Relationship and Types of Services: 120 days after SEC approval of the rule change
- NASD Rule 2711(h)(2)(G)—Exemption from Disclosure Requirements:
  - As applied to disclosures under NASD Rules 2711(h)(2)(B)(ii) and (iii): Immediate upon SEC approval of the rule change
  - As applied to disclosures under NASD Rule 2711(h)(2)(F): 120 days after SEC approval of the rule change
- NASD Rule 2711(j)—Prohibition of Retaliation Against Research Analysts: Immediate upon SEC approval of the rule change
- NASD Rule 2711(k)—Small Firm Exemption: Immediate upon SEC approval of the rule change
- All other provisions: 60 days after SEC approval of the rule change

#### 4. NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Exchange Act,<sup>48</sup> which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that this proposed rule change will reduce or expose conflicts of interest and thereby significantly curtail the potential for fraudulent and manipulative acts. NASD further believes that the proposed rule change will provide investors with better and more reliable information with which to make investment decisions.

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

The NYSE and the 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, 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 on the proposed rule changes. Comments received by the SEC in response to the Original Notice will be addressed together with comments received after publication of NYSE Amendment No. 2 and NASD Amendment No. 2.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents,<sup>49</sup> the Commission:

<sup>48</sup> 15 U.S.C. 78o-3(b)(6).

<sup>49</sup> See Letters to James Brigagliano, Assistant Director, Trading Practices, Division, Commission from: Darla Stuckey, Corporate Secretary, NYSE, consenting to an extension of the statutory time under section 19(b)(2) of the Exchange Act, until the Commission takes action on Rule filing SR-NYSE-2002-49 (December 27, 2002); and Philip Shaikun, Assistant General Counsel, NASD consenting to an extension of the statutory time under section 19(b)(2) of the Exchange Act, until the Commission takes action on Rule filing SR-NASD-2002-154 (December 27, 2003).

<sup>47</sup> See Securities Exchange Act Release No. 47876 (May 15, 2003); See also Securities Exchange Act Release No. 46165 (July 3, 2002), 67 FR 46555 (July 15, 2002).