

companies covered by research analysts that they oversee.

Finally, the proposed rules impose additional registration, qualification, and continuing education requirements on research analysts. The proposed amendments would establish a new registration category and require a qualification examination for research analysts. The proposals would also impose requirements regarding the continuing education of certain registered persons consisting of a Regulatory Element and a Firm Element<sup>18</sup> to address applicable rules and regulations, ethics, and professional responsibility.

### III. Discussion

The Commission received a total of 26 comment letters from 22 commenters on the proposed rule changes.<sup>19</sup> As discussed in detail below, although commenters generally supported the fundamental goals and objectives behind the proposed rule changes, many commenters also believed that certain of the initial proposals should be revised, and some suggested substantive changes. In response to various concerns and suggestions raised by commenters, the NYSE filed NYSE Amendment No. 3, and the NASD filed NASD Amendment No. 3, to their proposed rule changes.

After careful review, the Commission finds, as discussed more fully below, that the proposed rule changes, as amended, are consistent with the requirements of the Exchange Act and the regulations thereunder applicable to the NYSE and NASD.<sup>20</sup> In particular, the Commission believes that the proposals are consistent with Sections 6(b)(5) and 6(b)(8) of the Exchange Act,<sup>21</sup> Sections 15A(b)(6) and 15A(b)(9) of the Exchange Act,<sup>22</sup> and Section 15D of the Exchange Act, which was enacted as part of the SOA.

Section 6(b)(5) requires, among other things, that the rules of an exchange be

designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of free trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest. Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 6(b)(8) of the Exchange Act prohibits the rules of an exchange from imposing any burden on competition not necessary or appropriate in furtherance of the purposes of the statute.

Section 15A(b)(6) requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable 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 and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Section 15A(b)(9) requires that the rules of an association not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission also believes that the rules, as amended, fulfill the mandates of the SOA<sup>23</sup> that require that rules be implemented that are reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, and to improve the objectivity of research, provide investors with more useful and reliable information, and to require disclosure in public appearances and research reports of conflicts of interest that are known or should have been known by the securities analyst or the broker-dealer to exist at the time of the appearance or the date of distribution of the report.

Section 3(f) of the Exchange Act directs the Commission to consider, in addition to the protection of investors, whether approval of a rule change will promote efficiency, competition, and capital formation.<sup>24</sup> In approving the proposed rule changes, the Commission has considered their impact on

efficiency, competition, and capital formation.

The Commission believes the rule changes, as amended, promote the independence of research analysts and the objectivity of research. The rule proposals are reasonably designed to require analysts to disclose in public appearances, and broker-dealers to disclose in research reports, conflicts of interest of which they know or should know to exist at the time of the appearance or the date of the report. As such, the rules should provide investors with more useful and reliable information and promote greater public confidence in securities research.

#### *A. Solicitation of Investment Banking Business [NYSE Rule 472(b)(5) and NASD Rule 2711(c)(4)]*

Under the initial proposals, a research analyst would have been prohibited from issuing research reports or making public appearances concerning a company if the analyst engaged in any communication with the company in "furtherance of obtaining investment banking business" prior to the time the company entered into a letter of intent or other written agreement that designated the analyst's firm as underwriter of the company's initial public offering.

Commenters expressed substantial concern regarding this provision, largely arguing that the phrase "in furtherance of obtaining investment banking business" was overly broad and several suggested alternative language.<sup>25</sup> They also expressed concern that the vagueness of the proposals would discourage analysts from visiting and communicating with private companies because firms would be unsure of what communications would, especially in hindsight, be considered "in furtherance of obtaining investment banking business."<sup>26</sup>

Commenters also requested clarification on whether the consequence of a research analyst's participation in a communication "in furtherance of obtaining investment banking business" would be a permanent ban on the analyst writing research reports on that issuer, even where the analyst was no longer employed by the same firm. Commenters argued for a time limit on the research ban, and against the retroactive application to communications made prior to the effective date of the rule or in cases

<sup>18</sup> The Firm Element requires broker-dealers to keep employee education current by means of a formal, ongoing training program. Broker-dealers must ensure that training is relevant to identified needs and that it is adequate to convey the desired information relating to products and job functions. The Regulatory Element requires that broker-dealers conduct an annual needs analysis and focuses on compliance, regulatory, ethical, and sales-practice standards. All registered persons must participate in a prescribed computer-based training session within 120 days of their second registration anniversary date, and every third year thereafter. See generally *Content Outline For The Regulatory Element*, Securities Industry/Regulatory Council on Continuing Education (December 2000).

<sup>19</sup> See notes 6 and 8 *supra*.

<sup>20</sup> See 15 U.S.C. 19(b)(2).

<sup>21</sup> 15 U.S.C. 78f(b)(5) and (8).

<sup>22</sup> 15 U.S.C. 78o-3(b)(6) and (9).

<sup>23</sup> See Exchange Act Section 15D, 15 U.S.C. 78o-6.

<sup>24</sup> 15 U.S.C. 78c(f).

<sup>25</sup> See Adams *et al.* letter; SIA March 10th letter; Stifel letter; SunTrust letter; and Wilmer March 11th letter.

<sup>26</sup> See SIA March 10th letter; Stifel letter; and SunTrust letter.