

pre-approval and disclosure requirements for such research analysts.¹¹³

The SROs do not believe that it is appropriate to provide exemptions from the trading limitations for a certain class of individuals who meet the definition of "research analyst."¹¹⁴ The SROs further note that the current rules provide for exceptions to the trading restrictions for certain investment funds, including investments in registered diversified investment companies as defined in Section 5(b)(1) of the Investment Company Act of 1940.¹¹⁵

The SOA requires disclosure of the extent to which a research analyst has debt or equity investments in the issuer that is the subject of the research report or public appearance.¹¹⁶ Current NASD Rule 2711(h)(1)(A) requires disclosure of whether the "research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position)."¹¹⁷ The Commission believes that NASD Rule 2711(h)(2), and NYSE Rule 472(k)(1) and (2), as amended, satisfy the requirements of Exchange Act 15D(b)(1).¹¹⁸

The Commission believes that the modified rule proposals reflect an appropriate compromise between addressing commenters' concerns and mitigating conflicts of interest that can arise when an analyst invests in the securities of companies the analyst covers. The Commission finds that the proposals are consistent with the Exchange Act, particularly Sections 6(b)(5), 6(b)(8), 15A(b)(6), and 15A(b)(9).

G. Termination of Coverage [NYSE Rule 472(f)(5) and NASD Rule 2711(f)(6)]

The original proposals require notification to customers when a firm withdraws research coverage of a subject company, and distributions of a final research report that includes a final recommendation or rating. The proposed rules also would require that notice of this withdrawal must be made in the same manner as the initial

research coverage provided by the broker-dealer.

Several commenters expressed support for requiring firms to publish notice of withdrawal of research coverage of a company.¹¹⁹ However, commenters requested clarification with respect to the meaning of the term "withdrawal," and requested guidance regarding the requirement that notice of withdrawal must be made "in the same manner as when research coverage was first initiated by the member."¹²⁰

After considering commenters' concerns, the SROs filed amendments to require notice of "termination" of research coverage, rather than withdrawal or discontinuation. The NASD intends to provide general guidance as to what constitutes "termination," and will also consider such scenarios on a case-by-case basis.¹²¹

The SROs also filed amendments to respond to commenters' concerns regarding the meaning of the requirement that the final notice must be "made in the same manner" as when research coverage was "first initiated by the member."¹²² After considering comments, the SROs modified the proposals to require that the member make the final research report on the subject company available using means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on that subject company. The SROs also require that the final report must be comparable in scope and detail to prior research reports.

The rule proposals continue to require that the final report include a final recommendation or rating. However, the SROs have specified that a final recommendation or rating will not be required in cases where it is impracticable for the member to produce a comparable report (e.g., if the research analyst covering the subject company has left the member, or where the member has terminated coverage on an industry or sector). In such cases, the rationale for termination will be required.

The Commission finds that the proposed amendments requiring notice of termination of coverage will provide investors with important information to better evaluate the usefulness of research, including whether the firm is no longer covering the issuer. The

public may not be fully informed where a firm terminates coverage of a company without disclosing the termination to customers, and without providing customers with a final rating or recommendation, even in cases where a ratings change may have been warranted. The Commission believes that the amendments requiring notice of "termination" respond to commenters' concerns regarding what would constitute "withdrawal," while providing investors with important information. Therefore, the Commission believes these proposals are consistent with the Exchange Act, including sections 6(b)(5), 6(b)(8), 15A(b)(6) and 15A(b)(9).

H. Quiet Periods on the Issuance of Research Reports [NYSE Rule 472(f) and NASD Rule 2711(f)]

The SOA requires establishment of periods during which brokers or dealers who have participated or are to participate in a securities offering as underwriters or dealers may not publish or otherwise distribute research reports related to such securities.¹²³ Current SRO rules impose quiet periods on underwriting managers and co-managers for 40 calendar days following an initial public offering and 10 calendar days following a secondary offering, but do not impose these restrictions on other members of the underwriting syndicate or selling group. In order to comply with the SOA, the SRO proposals establish a 25 calendar-day period after the "date of the offering" during which a member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may not publish or otherwise distribute a research report or make a public appearance regarding that issuer.¹²⁴

Most commenters did not object to this proposed provision. One commenter, however, argued that the SOA does not require the SROs to apply the research blackout to every dealer that participates in the offering in any manner, including where the dealer has no agreement with the issuer or any underwriter to distribute the securities or to provide research about the issuer.¹²⁵

The SROs have not modified this proposal. The NYSE notes that the 25-day prohibition effectively codifies quiet periods that exist because of the

¹¹³ See CSFB letter and Schwab March 20th letter.

¹¹⁴ See NASD Response to Comments and NYSE Amendment No. 3.

¹¹⁵ See NYSE Rule 472(e)(4)(v) and (vi), and NASD Rule 2711(g)(5)(A) and (B); 15 U.S.C. 80a-5(b)(1).

¹¹⁶ See 15 U.S.C. 78o-6(b)(1).

¹¹⁷ In NYSE Amendment No. 3, the Exchange proposed to amend NYSE Rule 472(k)(1)(iii)(b) in order to require disclosure of the nature of the analyst's financial interest.

¹¹⁸ 15 U.S.C. 78o-6(b)(1).

¹¹⁹ See AIMR March 6th letter; NASAA letter; and SIA March 10th letter.

¹²⁰ See Schwab March 20th letter and SIA March 10th letter.

¹²¹ See NASD Response to Comments.

¹²² See SIA March 10th letter.

¹²³ See 15 U.S.C. 78o-6(a)(2).

¹²⁴ See NYSE 472(f)(3) and NASD 2711(f)(2). The Commission notes that the SROs have not proposed to impose a quiet period on non-managers that participate in secondary offerings.

¹²⁵ See Sullivan letter.