

Notice to Members

AUGUST 2002

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Investment Banking
Research Reports
Small Firms

REQUEST FOR COMMENT

ACTION REQUESTED BY AUGUST 30, 2002

Research Analysts and Research Reports

NASD Requests Comment on Application of Rule 2711 to Small Firms; **Comment Period Expires on August 30, 2002**

Executive Summary

On May 10, 2002, the Securities and Exchange Commission (SEC) approved new NASD Rule 2711, Research Analysts and Research Reports. The rule is intended to address potential conflicts of interest in the issuance of research reports by members, improve the objectivity of research, and provide investors with more useful and reliable information when making investment decisions. The SEC also approved on that day similar amendments to New York Stock Exchange (NYSE) Rule 472. The rules will be implemented in phases during the period from July 9, 2002 to November 6, 2002.

On July 1, 2002, NASD filed with the SEC a rule change that, among other things, delayed the effectiveness of two provisions of Rule 2711 for small firms. These delaying amendments establish November 6, 2002, as the effective date for Rules 2711(b) and (c) for members that have engaged in a limited number of investment banking transactions over the previous three years. Rules 2711(b) and (c) prohibit a research analyst from being subject to the supervision or control of the member's investment banking department and require compliance personnel to intermediate certain communications between research, investment banking, and the company that is the subject of the research report.

This *Notice* requests comment on whether smaller NASD members should be exempt from certain provisions of Rule 2711. The *Notice* seeks comment on which provisions of Rule 2711 present the greatest challenges for small firms. To the extent NASD determines that it should provide exemptions for small firms, NASD invites comment on which firms should be eligible for these exemptions.

Questions or comments concerning NASD Rule 2711 or this *Notice* may be directed to the NASD Corporate Financing Department at (240) 386-4623.

02-44

Request for Comment

NASD requests comment on whether certain small members should be eligible for exemptions from certain provisions of NASD Rule 2711. Comments must be received by August 30, 2002. Members and interested persons can submit their comments using the following methods:

- ▶ mailing in Attachment A—Request for Comment Form—along with written comments
- ▶ mailing in written comments
- ▶ e-mailing written comments to pubcom@nasd.com
- ▶ submitting written comments online on our Web Site (www.nasd.com)

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Important Note: The only comments that will be considered are those submitted in writing by mail, our Web Site, or by e-mail.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the NASD Board of Governors and the SEC.

Background and Discussion

Delaying Amendments for Small Firms

In response to requests from some of our smaller members, on July 1, 2002, NASD filed with the SEC a rule change that, among other things, established November 6, 2002, as the effective date for Rules 2711(b) and (c) for smaller members. These delaying amendments applied to members that over the previous three years, on average each year, have: participated in 10 or fewer investment banking transactions as manager or co-manager; and generated no more than \$5 million in gross investment banking revenues from those transactions.

Regulatory Relief for Small Firms

NASD is soliciting comment during the delay on whether small firms should be eligible for exemptions from certain provisions of Rule 2711 on a permanent basis. Accordingly, NASD requests comment on several questions.

First, NASD requests comment on the potential conflicts of interest faced by smaller firms when they issue research reports. Are the research reports issued by smaller firms any more or less objective than those issued by larger firms? What factors account for any differences in objectivity? To what extent do the conflicts of interest faced by smaller firms differ from those faced by larger firms?

Second, NASD requests comment on whether smaller firms have adopted procedures, other than those required by Rule 2711, to address these conflicts. How effective have any such procedures been?

Third, NASD requests comment on whether any provision of Rule 2711 imposes a burden that is unique to smaller firms. Does any unique burden outweigh any potential benefit to the investing public, and thus justify an exemption for smaller firms?

Fourth, if NASD determined to provide an exemption from certain provisions of the rule to smaller firms, what would be the best method to differentiate between firms that should be eligible for the exemption and those that should not be eligible? Is the transactions and revenues test that was adopted for the delaying amendment appropriate? Are there factors other than the number of investment banking transactions or the amount of investment banking revenues that NASD should consider in determining which members are “small firms”?

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ATTACHMENT A

Request for Comment Form

We have provided below a form that members and other interested parties may use in addition to written comments. This form is intended to offer a convenient way to participate in the comment process, but does not cover all aspects of the proposal described in the *Notice*. We therefore encourage members and other interested parties to review the entire *Notice* and provide written comments, as necessary.

Instructions

Comments must be received by August 30, 2002. Members and interested parties can submit their comments using the following methods:

- ◆ mailing in this form with attached comments
- ◆ e-mailing written comments to *pubcom@nasd.com*
- ◆ mailing in written comments
- ◆ submitting comments online at our Web Site (*www.nasd.com*)

This form and/or written comments should be mailed to:

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW

Washington, DC 20006-1500

Research Analysts and Research Reposts

The staff requests input from members and other interested parties on whether NASD should grant regulatory relief from NASD Rule 2711 for small firms. In particular, the staff seeks comment on the following questions:

1. Are research reports issued by smaller firms more objective than those issued by larger firms?
 Yes No See my attached written comments
2. Do the conflicts of interest faced by smaller NASD firms when they issue research reports differ from those faced by other members?
 Yes No See my attached written comments
3. Have smaller firms adopted procedures, other than those required by Rule 2711, to address conflicts of interest that arise when they issue research reports?
 Yes No See my attached written comments
4. Does any provision of NASD Rule 2711 impose a burden that is unique to smaller firms?
 Yes No See my attached written comments
5. Does any unique burden imposed on smaller firms by a provision of Rule 2711 outweigh the potential benefits to the investing public from the provision, and thus justify an exemption for small firms?
 Yes No See my attached written comments
6. Is the appropriate test for determining which firms qualify for regulatory relief from Rule 2711 a test that includes members that, on average over the past three years, have participated in 10 or fewer investment banking transactions as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions?
 Yes No See my attached written comments
7. Are there factors other than the number of investment banking transactions and amount of investment banking revenues that NASD should consider in determining which firms qualify for regulatory relief?
 Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

An NASD Member

An Investor

A Registered Representative

Other: _____