

March 7, 2002

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **SR-NASD-2002-21, Amendment No. 1** – Proposed Rule Regarding
Research Analyst Conflicts of Interest

Dear Ms. England:

Pursuant to our conversations with Thomas Eidt of the Division of Market Regulation, NASD Regulation, Inc. (“NASD Regulation”) hereby submits Amendment No. 1 to SR-NASD-2000-21 (the “rule filing”). In response to questions and comments from the SEC staff, NASD Regulation staff is revising its response to Items 1(b) and 1(c) of the Form 19b-4 to indicate the impact that the proposed rule change would have on NASD Rule 2210. Additionally, NASD Regulation is inserting language in the Purpose section of the Form 19b-4 and the corresponding section of the Federal Register notice to clarify how the current disclosure requirements regarding securities recommendations in NASD Rule 2210 would apply if proposed NASD Rule 2711 is approved by the SEC. Finally, NASD Regulation is revising the provisions requiring disclosure of actual material conflicts of interest to conform its provisions to those of the New York Stock Exchange (NYSE).

1. Item 1(b) of Form 19b-4 asks whether the self-regulatory organization reasonably expects the proposed rule change to have any direct effect, or significant indirect effect, on the application of any other SRO rule, and to describe the anticipated effect. On page 12 of the rule filing, the following change is made to the response to Item 1(b) (deletions are bracketed and new language is underlined):

(b) [Not applicable.] NASD Rule 2210(d)(2)(B)(i) provides that, in making a recommendation in advertisements and sales literature, a member must disclose, as applicable:

- that the member usually makes a market in the recommended security, or that the member or associated persons will sell to or buy from customers on a principal basis;

- that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the recommended issuer, unless the extent of such ownership is nominal; and
- that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

While the proposed rule change would not change the language of Rule 2210, its requirements may overlap with Rule 2210(d)(2)(B)(i)'s disclosure requirements with regard to equity security research reports. In this regard, both Rule 2210(d)(2)(B)(i) and the proposed rule change require certain disclosures if the member makes a market in the securities of a company that is the subject of a research report that includes a recommendation. To the extent there are differences in these disclosure standards regarding market-making activities, the requirements of the proposed rule change would govern. The other disclosure requirements of Rule 2210(d)(2)(B)(i) would continue to apply in addition to the proposed rule change's disclosure requirements. Thus, for example, if a member holds options, rights or warrants to purchase the securities of a company whose securities are recommended in a research report, this fact would have to be disclosed in the research report (unless the extent of such ownership is nominal) even if the member did not own 1% or more of any class of equity securities of the subject company, which would be the threshold for disclosing ownership of a subject company's securities under the proposed rule change.

2. Item 1(c) requests the file numbers for prior filings with regard to any existing rule specified in response to Item 1(b). Because Item 1(b) now references Rule 2210, the response to Item 1(c) on page 12 of the rule filing is amended as follows (deletions are in brackets and new language is underlined):

(c) [Not applicable.] NASD Rule 2210 and its predecessor (Article III, Section 25 of the Rules of Fair Practice) have been amended effective August 2, 1983; June 5, 1987; July 1, 1988; November 28, 1988; June 26, 1990; March 27, 1991; September 13, 1991; November 16, 1992; amended by SR-NASD-92-53 effective July 1, 1993; amended by SR-NASD-93-66 effective March 17, 1994; amended by SR-NASD-95-12 effective August 9, 1995; amended by SR-NASD-95-39 effective August 20, 1996; amended by SR-NASD-97-33 effective May 9, 1997; amended by SR-NASD-97-28 effective August 7, 1997; amended by SR-NASD-98-29 effective November 16, 1998; amended by SR-NASD-98-28 effective July 15, 1998; amended by SR-NASD-98-57 effective March 26, 1999; amended by SR-NASD-98-32 effective April 1, 2000; and amended by

SR-NASD-97-89 effective February 29, 2000. Additionally, there are two outstanding proposed rule changes that would amend Rule 2210: SR-NASD-98-01 (concerning related performance information) and SR-NASD-2000-12 (amendments to rules governing communications with the public).

3. In addition, we are revising the Purpose section of the Form 19b-4 and its corresponding section in the Federal Register notice of the proposed rule change. In this regard, the first full paragraph on page 29 and the first full paragraph on page 60 of the rule filing (both of which are identical) are revised as follows (new language is underlined):

Finally, in addition to the disclosure required by this proposed rule change, members and research analysts would be required to provide disclosure in research reports and public appearances that is required by applicable law or regulation, including NASD Rule 2210 and the anti-fraud provisions of the federal securities laws. In particular, NASD Rule 2210(d)(2)(B)(i) provides that, in making a recommendation in advertisements and sales literature, a member must disclose, as applicable:

- that the member usually makes a market in the recommended security, or that the member or associated persons will sell to or buy from customers on a principal basis;
- that the member and/or its officers or partners own options, rights or warrants to purchase any of the securities of the recommended issuer, unless the extent of such ownership is nominal; and
- that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years.

As discussed above, to the extent that the proposed rule change's disclosure requirements regarding market-making activities differ from those in Rule 2210(d)(2)(B)(i), the proposed rule change provisions would govern. However, the other disclosure requirements of Rule 2210(d)(2)(B)(i) would continue to apply to advertisements and sales literature (including research reports) in addition to the proposed rule change's disclosure requirements. Thus, a member would continue to be required to disclose in research reports if the member buys the recommended securities from or sells them to customers on a principal basis, if the member or its officers or partners own options, rights or warrants to purchase any securities of the recommended issuer in any amount (unless the extent of such ownership is nominal), and if the

member was a manager or co-manager of a public offering of the recommended issuer's securities within the last three years.

4. In addition to the changes requested by SEC staff, NASD Regulation is making a technical correction to the provisions of the proposed rule change that would require disclosure of any other actual material conflicts of interest. As currently written, the proposed rule change would require disclosures of any other actual material conflict of interest of the research analyst or member of which either the member or analyst knows or has reason to know. This provision differs from the comparable provision in the NYSE analyst conflicts proposal, which only requires disclosure of actual material conflicts of interest of the member or member organization of which the *research analyst* knows or has reason to know. We believe that the NASD provision on material conflicts should be revised to conform to the comparable NYSE provision. In addition to harmonizing the respective rule provisions, this change would preserve the ability of member firms to use Chinese Wall policies and procedures to shield research analysts from conflicts of interest that may be known in other departments of a firm, but of which the analyst is not aware.

Accordingly, the language in proposed Rule 2711(h)(1)(B), (C) and (D) that appears on pages 9 and 41 of the rule filing is revised as follows (deletions are bracketed and new language is underlined):

(B) if, as of five business days before the publication of the research report or the public appearance, the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company; and

(C) any other actual, material conflict of interest of the research analyst or member of which the research analyst [or member] knows or has reason to know at the time of publication of the research report[,] or [of which the research analyst knows or has reason to know] at the time of the public appearance.; and]

[(D) any other actual, material conflict of interest of the member of which the member knows or has reason to know at the time of publication of the research report, or of which the research analyst knows or has reason to know at the time of the public appearance.]

Additionally, the first sentence of the paragraph that begins "Finally, the proposed rule change contains ..." that appears on pages 26 and 57 of the rule filing is revised as follows (deletions are in brackets):

Finally, the proposed rule change contains a provision that would require disclosure in research reports and public appearances of any other actual,

Katherine A. England
March 7, 2002
Page 5 of 5

material conflict of interest of which the [member or] analyst knows or has reason to know.

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If you have any questions, please contact Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, NASD Regulation, Inc., at (240) 386-4533, Joseph P. Savage, Counsel, Investment Companies Regulation, NASD Regulation, Inc., at (240) 386-4534, or Philip Shaikun, Assistant General Counsel, NASD Regulation, Inc., at (202) 728-8451. The fax number of Investment Companies/Corporate Financing is (240) 386-4572.

Sincerely,

Thomas M. Selman
Senior Vice President
Investment Companies/Corporate Financing

cc: Patrice M. Gliniecki
Joseph P. Savage
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