

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47876; File Nos. SR-NASD-2003-79; SR-NYSE-2003-17]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Changes by the National Association of Securities Dealers, Inc. and the New York Stock Exchange, Inc. Relating to Establishing Effective Dates for Certain Provisions of NASD Rule 2711, Research Analysts and Research Reports, and NYSE Rule 472, Communications with the Public

May 15, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 6, 2003, the National Association of Securities Dealers, Inc. ("NASD"), and on May 9, 2003, the New York Stock Exchange, Inc. ("NYSE" or "Exchange"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule changes as described in Items I, II, and III below, which Items have been prepared by the respective self-regulatory organizations ("SROs"). The SROs have designated the proposed rule changes as constituting stated policies, practices, or interpretations with respect to the meaning, administration, or enforcement of an existing rule series under paragraph (f)(1) of Rule 19b-4 under the Act,<sup>3</sup> which render the proposals effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons.

#### I. Self-Regulatory Organizations' Statements of the Terms of Substance of the Proposed Rule Changes

##### A. NASD

NASD is filing with the SEC a proposed rule change to establish July 30, 2003, or until a superseding permanent exemption is approved by the SEC and becomes effective, as the effective date for NASD Rules 2711(b) and (c) for members that over the previous three years, on average, 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. NASD Rules 2711(b) and (c), when effective, prohibit a research analyst from being

subject to the supervision or control of any employee of a member's investment banking department, and will further require legal or compliance personnel to intermediate certain communications between the research department and either the investment banking department or the company that is the subject of a research report or recommendation ("subject company").

##### B. NYSE

The NYSE is filing with the SEC a proposed rule change that would establish July 30, 2003, or until such date as a permanent exemption is approved by the SEC and becomes effective, as the effective date for certain provisions of Rule 472 ("Communications with the Public") for certain members and member organizations.

#### II. Self-Regulatory Organizations' Statements of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

In their original rule filings with the Commission, the SROs included statements concerning the purpose of, and basis for, the proposed rule changes and discussed any comments they received on the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. The SROs have prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organizations' Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

###### 1. NASD's Purpose

NASD is filing the proposed rule change to establish July 30, 2003, or until the date a superseding permanent exemption is approved by the SEC and becomes effective, as the effective date for NASD Rules 2711(b) and (c) for members that over the previous three years, on average per year, 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. Pursuant to the SEC's approval of SR-NASD-2002-87<sup>4</sup> and SR-NASD-2002-161<sup>5</sup>, NASD Rules 2711(b) and (c), as applied to this class of members, otherwise would have gone into effect

on May 5, 2003. NASD seeks to delay implementation of these provisions for these members while it finalizes a proposal to create a permanent exemption for firms that engage in limited underwriting activity. The purpose of the delayed implementation—and ultimately a permanent exemption—is to preserve the role of certain smaller firms that often are the sole or primary source of underwriting and research coverage for some smaller or regional companies.

On May 10, 2002, the Commission approved new NASD Rule 2711, which governs conflicts of interest when research analysts recommend equity securities in research reports and during public appearances.<sup>6</sup> The Commission approved a staggered implementation period for the rule. Most provisions of the rule became effective on July 9, 2002, including those that restrict supervision and control of research analysts by the investment banking department. The "gatekeeper" provisions, described below, became effective September 9, 2002. The remaining provisions of the Rule became effective on November 6, 2002.

NASD Rule 2711(b) contains provisions that generally restrict the relationship between the research and investment banking departments, including "gatekeeper" provisions that require a legal or compliance person to intermediate certain communications between the research and investment banking departments. NASD Rule 2711(b)(1) prohibits a research analyst from being under the control or supervision of any employee of the investment banking department. NASD Rule 2711(b)(2) prohibits employees in the investment banking department from reviewing or approving any research report prior to publication. NASD Rule 2711(b)(3) creates an exception to (b)(2) to allow investment banking personnel to review a research report prior to publication to verify the factual information contained therein and to screen for potential conflicts of interest. Any permissible written communications must be made through an authorized legal or compliance official or copied to such official. Oral communications must be made through, or in the presence of, an authorized legal or compliance official and must be documented.

Similarly, NASD Rule 2711(c) restricts communications between a member and the subject company of a research report, except that a member

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(1).

<sup>4</sup> See Securities Exchange Act Release No. 46165 (July 3, 2002), 67 FR 46555 (July 15, 2002).

<sup>5</sup> See Securities Exchange Act Release No. 46949 (December 4, 2002), 67 FR 76202 (December 11, 2002).

<sup>6</sup> See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) ("May 10th order").

may submit sections of the research report to the company to verify factual accuracy and may notify the subject company of a ratings change after the "close of trading" on the business day preceding the announcement of the ratings change. Submissions to the subject company may not include the research summary, the rating or the price target, and a complete draft of the report must be provided beforehand to legal or compliance personnel. Finally, any change to a rating or price target after review by the subject company must first receive written authorization from legal or compliance.

As the Commission noted in the May 10th order, several commenters argued that the gatekeeper provisions 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. NASD received similar comments in response to *Notice to Members* 02-44, which sought comment on whether certain members should be exempted from certain provisions of the Rule and what criteria should be employed to fashion such an exemption.

NASD received 10 comments in response to the *Notice to Members*.<sup>7</sup> Generally, the comments emphasized the financial and administrative burdens imposed by NASD Rule 2711 to implement the gatekeeper provisions and to structure firms so that research personnel are not subject to supervision by investment banking personnel. Commenters argued that the conflicts addressed by NASD Rule 2711 are less pronounced with respect to smaller firms and that the burdens of compliance could force firms to discontinue their research business.

In response to the comments, NASD has been developing a proposed permanent exemption to preserve the role of smaller firms in the capital

raising process and to ensure research coverage for smaller or regional companies.

NASD believes that compliance with both NASD Rules 2711(b) and (c) continues to pose financial and administrative challenges for certain smaller firms. As such, NASD believes it appropriate to extend the effective date of those provisions for members that over the previous three years, on average per year, 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. NASD proposes to delay the effective date of NASD Rules 2711(b) and (c) until July 30, 2003, or until the date a superseding permanent exemption is approved by the SEC and becomes effective.

As a further condition for the delayed implementation date, those firms that meet the eligibility requirements outlined above would be required to maintain records of communications that would otherwise be subject to the gatekeeper provisions of NASD Rules 2711(b) and (c).

## 2. NASD's Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that NASD's rules must 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 would 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.

## 3. NYSE's Purpose

The Exchange is filing the proposed rule change to establish July 30, 2003, or until such date as a permanent exemption is approved by the SEC and becomes effective, as the effective date for NYSE Rule 472(b)(1), (2) and (3), subject to certain conditions, for members and member organizations that over the previous three years, on average per year, have participated in ten or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking

revenues from those transactions (hereinafter referred to as "small firms").

In the May 10th order, the Commission approved amendments to NYSE Rules 351 ("Reporting Requirements") and 472, which place prohibitions and/or restrictions on Investment Banking Department, Research Department, and Subject Company relationships and communications and impose new disclosure requirements on members and member organizations and their associated persons. At the same time, the Commission also approved a staggered implementation period for the rules. Most provisions of the rules became effective on July 9, 2002, including those that restrict supervision and control of associated persons by the investment banking department and those that require disclosure of investment banking compensation received from a subject company. The "gatekeeper" provisions, described below, became effective on September 9, 2002.

On July 9, 2002, the Exchange filed, for immediate effectiveness, SR-NYSE-2002-23<sup>9</sup> that extended the effective date to November 6, 2002 for NYSE Rule 472(b)(1), (2) and (3) ("gatekeeper" provisions) for small firms.

On November 7, 2002, the Exchange filed, for immediate effectiveness, SR-NYSE-2002-60,<sup>10</sup> which extended the delayed effective date of the gatekeeper provisions for small firms until May 5, 2003.

## Small Firm Relief

NYSE Rule 472 contains provisions that generally restrict the relationship between the research and investment banking departments, including "gatekeeper" provisions that require a legal or compliance person to intermediate certain communications between the research and investment banking departments. NYSE Rule 472(b)(1) prohibits an associated person (also referred to throughout this filing as a "research analyst") from being under the control or supervision of any employee of the investment banking department.

NYSE Rule 472(b)(1) also prohibits the investment banking department from reviewing or approving any research reports prior to distribution. NYSE Rule 472(b)(2) creates an exception to the prohibition of (b)(1) to allow investment banking personnel to review a research report prior to

<sup>7</sup> Letter from David Amster, CRT Capital Group, dated August 19, 2002; Letter from Peter V.B. Unger, Fulbright & Jaworski, LLP, dated August 30, 2002; Letter from First Analysis Securities Corp., dated August 30, 2002; Letter from Scott Cleland and John Eade, Investors' Research Association, dated August 29, 2002; Letter from W. Gray Medlin, The Carson Medlin Co., dated August 29, 2002; Letter from Cathryn Streeter, BioScience Securities, Inc., dated August 28, 2002; E-mail from James Nelson, Minnesota Valley Investments, dated July 31, 2002; E-mail from Joe B. Kercheville, Kercheville & Company, dated August 28, 2002; E-mail from Ray Chin, DBS Vickers Securities (USA) Inc., dated July 29, 2002; Letter from Stuart J. Kaswell, Securities Industry Association, dated August 30, 2002.

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> See Securities Exchange Act Release No. 46182 (July 11, 2002), 67 FR 47013 (July 17, 2002).

<sup>10</sup> See note 5 *supra*.

publication to verify the accuracy of information contained therein and to review for any potential conflicts of interest. Any permissible written communications must be made through legal or compliance or copied to legal or compliance. Oral communications must be made through, or in the presence of, legal or compliance personnel and must be documented.

Similarly, NYSE Rule 472(b)(3) restricts communications between a member or member organization and the subject company of a research report, except that a member or member organization may submit sections of the research report to the subject company to verify factual accuracy and may notify the subject company of a ratings change after the "close of trading" on the business day preceding the announcement of the ratings change. Submissions to the subject company may not include the research summary, the rating or the price target, and a complete draft of the research report must be provided beforehand to legal or compliance personnel. Finally, any change to a rating or price target after review by the subject company must first receive written authorization from legal or compliance.

As the Commission noted in the May 10th order, several commenters argued that the "gatekeeper" provisions would impose significant costs, especially for smaller firms that may have to hire additional personnel to comply with the requirements. 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 the investment banking or research business and/or reduce important sources of capital and research coverage for smaller companies.

Accordingly, the Exchange is proposing to delay implementation of NYSE Rules 472(b)(1), (2), and (3) until July 30, 2003, or until a permanent exemption is approved by the SEC and becomes effective, for small firms. Those members or member organizations that meet the eligibility requirements outlined above for the delayed implementation date would also be required to maintain records of communications that would otherwise be subject to the gatekeeper provisions of NYSE Rule 472(b).

#### 4. NYSE's Statutory Basis

The statutory basis for the proposed rule change is section 6(b)(5) of the

Exchange Act<sup>11</sup> which requires, among other things, that the rules of the Exchange 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.

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

The SROs do not believe that the proposed rule changes will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

#### *C. Self-Regulatory Organizations' Statements on Comments on the Proposed Rule Changes Received From Members, Participants, or Others*

The NASD and NYSE have not solicited or received written comments on the proposed rule changes.

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

The proposed rule changes have been filed by the SROs as stated policies, practices, or interpretations with respect to the meaning, administration, or enforcement of an existing rule series under Rule 19b-4(f)(1) under the Act.<sup>12</sup> Consequently, they have become effective pursuant to section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(1) thereunder.<sup>14</sup>

At any time within 60 days of the filing of such proposed rule changes, the Commission may summarily abrogate such rule changes if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing including whether the proposed rule changes are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submissions, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the

proposed rule changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filings will also be available for inspection and copying at the principal offices of the SROs. All submissions should refer to the file numbers SR-NASD-2003-79 and SR-NYSE-2003-17 and should be submitted by June 12, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. 03-12873 Filed 5-21-03; 8:45 am]

BILLING CODE 8010-01-P

## DEPARTMENT OF STATE

[Public Notice 4369]

### Determination and Certification Under Section 40A of the Arms Export Control Act

Pursuant to section 40A of the Arms Export Control Act (Pub. L. 90-629—22 U.S.C. 2771 *et seq.*), as added by section 330 of the Antiterrorism and Effective Death Penalty Act of 1996 (Public Law 104-132), and Executive Order 11958, as amended, I hereby determine and certify to the Congress that the following countries are not cooperating fully with United States antiterrorism efforts:

Cuba;  
Iran;  
Libya;  
North Korea;  
Sudan;  
Syria.

This determination and certification shall be transmitted to the Congress and published in the **Federal Register**.

Dated: May 15, 2003.

**Richard L. Armitage,**

*Deputy Secretary of State, Department of State.*

[FR Doc. 03-12874 Filed 5-21-03; 8:45 am]

BILLING CODE 4710-10-P

## TENNESSEE VALLEY AUTHORITY

### Paperwork Reduction Act of 1995, As Amended by Public Law 104-13; Proposed Collection; Comment Request

**AGENCY:** Tennessee Valley Authority.

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 17 CFR 240.19b-4(f)(1).

<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(1).

<sup>15</sup> 17 CFR 200.30-3(a)(12).