November 14, 2006

BY E-MAIL TO: rule-comments@sec.gov

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Nos. SR-NYSE-2006-77 and SR-NASD-2006-112; Proposed Rule Changes Relating to NYSE Rule 472 and NASD Rule 2711

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced rule filings ("Rule Filings") submitted to the Securities and Exchange Commission ("Commission") by the New York Stock Exchange LLC ("NYSE") and NASD, Inc. ("NASD" and, collectively with NYSE, "SROs"). We largely support the changes to NYSE Rule 472 and NASD Rule 2711 ("SRO Rules") set forth in the Rule Filings, which the SROs filed with the Commission for immediate effectiveness under Section 19(b)(3)(A) of the Securities Exchange Act of 1934 ("Exchange Act"). For the most part, the changes codify existing interpretive guidance relating to the SRO Rules[2] and make

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. '

[2] *See Joint Memorandum of NASD and the New York Stock Exchange* (March 2004), available in NASD Notice to Members 04-18; *Joint Memorandum of NASD and the New York Stock Exchange* (July 2002), available in NASD Notice to Members 02-39.

nonsubstantive, technical changes to clarify the intended meaning of the SRO Rules. However, the Rule Filings' changes to the SRO Rules that require member firms to conduct supervisory review and approval of research reports prepared by third parties ("Third Party Research Reports") are not simply codifications of the SROs' existing interpretive guidance. Rather, these changes represent a significant change in policy and impose substantial obligations on member firms. We believe these changes should not have been filed with the Commission for immediate effectiveness under Section 19(b)(3)(A) of the Exchange Act, and that they should be subject to the public notice and comment process required under Section 19(b)(2) of the Exchange Act.

Overview

We support the efforts of the SROs in reviewing their respective rules relating to preparation and distribution of research and especially in developing the *Joint Report by NASD and the NYSE On the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules*, which the SROs issued in December 2005 ("Joint Report"). In particular, we are pleased that the SROs have taken affirmative steps to implement many of the rule changes recommended in the Joint Report, both in the Rule Filings and in proposed rule changes the SROs submitted contemporaneously with the Rule Filings.[3] We look forward to providing separate comment on those additional substantive changes to the SRO Rules.

Moreover, we applaud the initiative of the SROs to engage markets, investors, and research providers in a review of the need for, and the costs, benefits and effects of, the regulation of research. SIFMA and member firms are dedicated to producing research of integrity and of value to investors. The SRO Rules were initially adopted in a piecemeal fashion and we believe it is appropriate for the SROs, along with the Commission, to continue to

[3] File Nos. SR-NASD-2006-112 and SR-NASD-2006-77.

scrutinize those rules to assess the extent to which, in light of experience, they unnecessarily overlap with other regulations, such as Regulation AC and impose any restrictions that are not warranted as to need, efficacy and the costs and distortions imposed. Further, the business of research will continue to evolve in response to other developments, both in the United States and in the global markets. We urge the SROs to continue their thoughtful review and assessment of their research rules.

Along those lines, we urge the SROs to work actively with their counterparts around the globe, as well as with the Commission, to develop standard protocols for disclosures in research reports. Currently, firms producing research on a global basis face a multiplicity of disclosure requirements and publication restrictions in the various markets in which they operate. If it has not already been done, it would be extremely helpful if the NASD and NYSE could designate contact people for non-U.S. regulators to reach, and seek to develop relationships with their non-U.S. counterparts through those contacts.

Specific Concerns with the Rule Filings

As a result of the Rule Filings, the SRO Rules now include the following requirements on member firms to conduct supervisory review and approval of Third-Party Research Reports:

- A registered principal (or supervisory analyst approved pursuant to NYSE Rule 344 of the New York Stock Exchange) must approve by signature or initial any third-party research distributed by a member.[4]

- All third-party research distributed by a member must be reviewed by the designated principal (or supervisory analyst approved pursuant to NYSE Rule 344) to determine that the applicable disclosures required by the SRO Rules 2711 are complete and accurate, and the content of the research report is consistent with all applicable standards regarding communications with the public.[5]

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4 *See* NASD Rule 2711(h)(13)(C), NYSE Rule 472(k)(4)(i)(a).

5 *See* NASD Rule 2711(h)(13)(C), NYSE Rule 472(k)(4)(i)(b).

We acknowledge that research reports are subject to the approval requirements of the SROs' rules regarding communication with the public.[6] However, until the submission of the Rule Filings, the SROs never specified that those requirements applied to Third-Party Research Reports. In fact, NYSE's published interpretation of Rule 472 indicates that its member firms may not be subject to the same review and approval requirements for externally prepared material, such as Third-Party Research Reports.[7] In addition, the SROs' detailed interpretive guidance provides no indication that the SROs' policy was to apply the approval requirements to Third-Party Research Reports. Rather, the SROs articulated less extensive requirements regarding member firms' distribution of Third-Party Research Reports.

Under the SROs' joint interpretive memoranda, member firms were required to include certain "Third-Party Research Disclosures" on any Third-Party Research Reports they distributed. In addition, member firms were required to adopt and implement written

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[6] NASD Rule 2210(b) and NYSE Rule 472(a)(1) require supervisory review and approval of communications with the public, including "sales literature." NASD Rule 2210(a)(2) and NYSE 472.10 extend those requirements to research reports through their respective definitions of the terms "sales literature" and "communications."

[7] NYSE Interpretation 472.10/07 provides that:

> Generally, all communications distributed to or made available to customers or the public must comply with Exchange standards, whether prepared by the member organization or externally. However, consideration will be given to requests for a waiver of this requirement where, among other factors:
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> - The member organization has no editorial control over the content, subject matter or timing of the material;
> - The material is otherwise obtainable and was not prepared at the request of or commissioned by the member organization;
> - The member organization and the preparer of the material are unaffiliated;
> - The preparer of the material is subject to a parallel and comparable system of regulation; and
> - The material is transmitted in its entirety (i.e., in full text) and does not contain any comment thereon by the member organization.

supervisory procedures reasonably designed to ensure compliance with the SRO Rules, which presumably included the interpretive guidance on Third-Party Research Disclosures.[8] However, the SROs had not specifically indicated that member firms would be required to review and approve the content of Third-Party Research Reports. The specificity of these requirements goes well beyond the requirements previously articulated by the SROs, and we have both substantive and procedural concerns regarding these aspects of the Rule Filings.

Substantive Concerns

Our substantive concerns with the supervisory review and approval requirements for Third-Party Research Reports arise out of a desire to maintain the timely flow of information to investors. We believe that investors benefit from the ability to receive information provided from different sources and perspectives in research reports. In particular, we believe that investors benefit from research prepared by member firms that have dedicated staff and resources to provide research coverage of issuer, as well as reputable non-member vendors, such as Standard & Poors ("S&P") and Morningstar, which are truly independent voices that are not subject to the types of conflicts of interest that sometimes exists within member firms.

However, the supervisory review and approval requirements will inhibit the timely dissemination of research in several respects. First, we believe the requirements create a supervisory burden that ultimately will discourage member firms from distributing Third-Party Reports. Second, we believe the requirements impose an unnecessarily duplicative level of supervisory review on the distribution of Third-Party Research Reports prepared by another member firm. Third, we believe the supervisory review and approval requirements impose a

[8] In any event, the SRO Rules now expressly require that member firms include the Third-Party Research Disclosures on Third-Party Research Reports. *See* NASD Rule 2711(h)(13)(A), NYSE Rule 472(k)(4)(i).

significant registration and qualification burden on member firms that are not in the business of preparing research reports. In addition, the NYSE's and NASD's requirements for review and approval of Third-Party Research Reports differ in a material respect. Finally, as a general policy matter, we believe the supervisory review and approval requirements are inconsistent with the SROs' (and the Commission's) objectives in requiring the distribution of Third-Party Research Reports under the Global Research Analyst Settlement.[9]

On previous occasions, we have expressed concerns about the effect of certain restrictions on a member firm's ability to publish research reports (*e.g.*, following a public offering), particularly as those restrictions put retail investors at a disadvantage to institutional investors.[10] We continue to believe that restrictions on a member firm's ability to promptly publish research reports puts retail investors at a disadvantage because institutional investors generally have access to research that is not subject to such restrictions (*e.g.,* research prepared by non-U.S. broker-dealers, buy side research). In our view, the SROs' supervisory review and approval requirements will substantially delay member firms' distribution of Third-Party Research Reports to their retail customers and could disadvantage retail investors further by creating a disparity between customers of different types of member firms. For example, retail customers of a member firm that relies on the use of Third-Party Research Reports could receive the Third-Party Research Reports well after customers of the member firm that prepared the research reports or the direct subscribers of non-member research (which are often institutional investors), thus putting them at an informational disadvantage.

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9 *See* Commission Litigation Release No. 18438 (October 31, 2003).

10 *See* Letter to Donald Van Weezel, NYSE, and Philip Shaikun, NASD from George R. Kramer, August 4, 2005; *see also* Letter to Jonathan G. Katz from Stuart J. Kaswell, April 11, 2002; Letter to James Brigagliano, SEC, from Scott C. Kursman, December 8, 2003.

(1) The Rule Filings Impose Significant Supervisory Burdens That Will Discourage Member Firms from Distributing Third-Party Research Reports.

In our view, the supervisory review and approval requirements articulated in the Rule Filings will add significant supervisory burdens that we believe will ultimately discourage member firms from distributing Third-Party Research Reports to their customers. Since the adoption of the SRO Rules in 2002, the preparation of research reports by member firms has been subject to extensive supervisory review requirements. NASD Rule 2210(b)(1) and NYSE Rule 472(a)(2) require the approval of research reports either by a Registered Principal or by a Supervisory Analyst. In addition, the SRO Rules expressly require member firms to adopt and implement supervisory procedures for compliance with the requirements regarding research reports.[11] However, the Rule Filings add an additional level of supervisory review to the distribution of Third-Party Research Reports by requiring that member firms review the content of all Third-Party Research Reports they distribute.

Currently, many member firms currently distribute Third-Party Research reports to their customers through subscriptions with vendors that specialize in preparing investment research. Those subscriptions provide member firms, and their customers, with research reports and other resources regarding a wide variety of issuers. For example, Morningstar and S&P both publish research reports on upwards of 1,500 different issuers. In many cases, member firms do not have the resources and infrastructure to offer this level of research coverage and therefore rely on these subscriptions to provide their customers high-quality investment research.

Each night, research vendors update their coverage on a number of issuers (sometimes several hundred) to reflect earnings releases and other developments. Moreover, research

[11] NASD Rule 2711(i), NYSE Rule 472(c).

vendors generally offer a variety of other materials relating to issuers, such as summary research reports covering a number of issues as well as industry reports and "consensus" reports. Accordingly, the actual number documents subject to supervisory review and approval each day under the Rule Filings can be substantially greater than the number of issuers whose coverage is updated. In order to satisfy the standards articulated in the Rule Filings, member firms will be required to hire a substantial number of additional supervisory personnel solely to review and approve Third-Party Research Reports.

Moreover, assuming it were possible to hire a sufficient number of properly-qualified personnel, the review as required under the Rule Filings is subject to virtually insurmountable hurdles. For example, because Third-Party Research Reports are often provided electronically by the vendor to the subscribing member firm, it is generally not possible to perform a pre-review of the reports. Also, the member firm's supervisory personnel do not have access to the authors of the Third-Party Research Reports in order to make inquiries, question assumptions, or to otherwise fulfill the requirements applicable to member firms' communications with the public. In addition, a member firm's supervisory personnel have no ability to change the content of Third-Party Research Reports if they identify an issue of concern. Furthermore, it is not feasible in most instances to remove specific reports or material from a member firm's subscription.

Certainly, we believe that member firms do have supervisory review obligations in connection with the distribution of Third-Party Research Reports. At a minimum, member firms should demand high standards from providers of Third-Party Research Reports, and should implement policies and procedures for "front-end" diligence reviews of research vendors as well as ongoing periodic reviews of the vendors' reports. This type of principles-based approach,

which NASD has articulated in the area of member firm oustourcing,[12] would be reasonable, viable, and, most importantly, meaningful with respect to protecting the interests of the investors who use Third-Party Research Reports. In addition, a principles-based approach to supervisory review of Third-Party Research Reports would enable member firms to conduct risk based assessments based on the size, history and reputation of particular research vendors.

We believe the supervisory review and approval requirements articulated in the Rule Filings will significantly delay member firms' timely dissemination of information to the marketplace, and, as a result, increase the informational disadvantage between retail and institutional investors. Moreover, we believe the supervisory review and approval standards will lead many member firms to discontinue providing their customers with Third-Party Research Reports, other than on an unsolicited basis. As a result, we believe that fulfilling the SROs' supervisory review and approval requirements ultimately will not benefit investors.

(2) The Rule Filings Impose an Unnecessarily Duplicative Level of Supervisory Review on Third-Party Research Reports Prepared by Member Firms

In addition to increasing member firms' overall supervisory obligations, the Rule Filings impose an unnecessarily duplicative level of review on Third-Party Research Reports that are prepared by another member firm. It appears that a member firm that distributes Third-Party Research Reports would have the same content review responsibility as the member firm that prepared the report when, as described above, the distributing firm does not have access to the authors of the Third-Party Research Reports. As such, we do not believe this added layer of review will add to the already thorough requirements governing the review and distribution of research reports. In our view, a member firm distributing a Third-Party Research Report should

[12] *See* NASD Notice to Members 05-48, *Members' Responsibilities When Outsourcing Activities to Third-Party Service Providers*.

be able to reasonably rely on the preparing firm's content review and approval pursuant to NASD Rule 2210(b)(1) and NYSE Rule 472(a)(2). We respectfully urge the SROs to make this rule language clear as to its scope.

(3) The Rule Filings Impose Significant Registration and Qualification Burdens on Member Firms that are not in the Business of Preparing Research Reports

As a result of the Rule Filings, the SRO Rules now impose new registration and qualification requirements on member firms that are not in the business of preparing research reports. Prior to the Rule Filings, it was clear that member firms that prepared research reports were subject to certain research-specific registration and qualification requirements. For example, research analysts generally must be registered and pass the Series 86 and 87 examinations.[13] NYSE and NASD Rules require member firm personnel who approve the content of research reports prepared by the member firm to pass either the Series 24 *and* 87 examinations or the Series 16 examination.[14] In addition, NASD Rule 1022(a)(5) provides that personnel who supervise the conduct of research analysts or supervisory analysts must pass the Series 24 Examination *and* either the Series 87 or Series 16 Examination.

As a result of the Rule Filings, the SRO Rules now expressly provide that member firms must review and approve the content of Third-Party Research Reports, which requirement imposes the research-specific requirements on member firms that simply distribute Third-Party Research Reports. Given the existing registration and qualification requirements applicable to the preparation and distribution of research reports, it was unnecessary to impose additional such

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13 *See* NASD Rule 1050, NYSE Rule 344.

14 NASD Notice to Members 04-81 provides that dual NASD/NYSE members or NASD-only members must have the content of research reports approved by someone who has passed either (1) the Series 24 and Series 87 or (2) the Series 16. NYSE members must have the content of research reports approved by someone who has passed the Series 16.

requirements on the distribution of Third-Party Research Reports. These requirements will impose a significant burden on member firms that rely on Third-Party Research Reports, and may discourage such firms from continuing to provide their customers with research reports, other than on an unsolicited basis. This result would only increase the informational disadvantages between retail and institutional customers, and we recommend that the SROs reconsider these requirements.

These requirements create significant additional difficulties for NYSE member firms, which are required to use Series 16 Supervisory Analysts to review the content of Third-Party Research Reports. As a practical matter, it is very difficult for member firms to hire Supervisory Analysts because NYSE rules do not permit persons to sit for the Series 16 examination unless they have functioned as an equity or credit analyst for at least three years. As a result, the additional registration and qualification requirements may leave NYSE member firms unable to hire the amount of personnel required to conduct the required reviews.

(4) The Rule Filings Create a Material Inconsistency between NASD and NYSE Rules.

Each of the Rule Filings includes an exception from the requirements on Third-Party Research Reports for reports that a member firm makes available to its customers either upon request or through its website.[15] As drafted, NYSE's Rule Filing applies the exception to the supervisory review and approval requirements *and* the Third-Party Research Disclosure requirements. However, NASD's Rule Filing applies the exception only to the Third-Party Research Disclosure requirements. It is not clear from the Rule Filings whether this difference

[15] NASD Rule 2711(h)(13)(B) and NYSE Rule 472(k)(4)(ii).

between the SRO Rules is intentional. In our view, NYSE's approach is the proper one, and we respectfully urge NASD to amend its rule language so that it is harmonized with NYSE's.

(5) The Rule Filings are Inconsistent with the Global Research Analyst Settlement's Requirement that Member Firms Make Available Third-Party Research Reports.

The supervisory review and approval requirements are inconsistent with regulatory efforts (by the SROs as well as the Commission and state securities regulators) to require or encourage the provision of independent Third-Party Research Reports under the Global Research Analyst Settlement.[16] One of the primary objectives of the Global Research Analyst Settlement was to provide customers with increased access to independent research reports, and, under the terms of that Settlement, the settling member firms were required to make Third-Party Research Reports available to their customers. Each of the settling member firms was required to contract with no fewer than three independent research firms to make independent research available to the firm's customers.

The settling member firms have dedicated a significant amount of effort and expense to implement these requirements of the Global Research Analyst Settlement, and other member firms have subsequently increased their customers' access to Third-Party Research Reports. In particular, member firms have dedicated substantial resources to be able to provide their customer with the same access to Third-Party Research Reports that customers have to research reports prepared by the member firm. However, by imposing the additional supervisory, registration, and qualification burdens described above, the supervisory review and approval requirements could hinder member firms' ability to provide equivalent access to proprietary

[16] *See* Commission Litigation Release No. 18438 (October 31, 2003).

research reports and Third-Party Research Reports, which is contrary to the goals of the Global Research Analyst Settlement.[17]

Procedural Concerns

The Rule Filings were submitted to the Commission pursuant to Rule 19b-4(f)(1) under the Exchange Act and, as such, were effective immediately upon filing with the Commission. However, the changes to the SRO Rules regarding supervisory review and approval of Third Party Research Reports should not have been filed with the Commission for immediate effectiveness. Section 19(b)(3)(A) of the Exchange Act provides that:

> a proposed rule change may take effect upon filing with the Commission if designated by the self-regulatory organization as (i) *constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization*, (ii) establishing or changing a due, fee, or other charge imposed by the self-regulatory organization, or (iii) concerned solely with the administration of the self-regulatory organization…(emphasis added).

Similarly, Rule 19b-4(f)(1) under the Exchange Act provides that "[a] proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the [Exchange] Act, 15 U.S.C. 78s(b)(3)(A), if properly designated by the self-regulatory organization as…[c]onstituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule."

The SROs represented in the Rule Filings that the changes to the SRO Rules were codifications of existing interpretive guidance or otherwise were nonsubstantive and technical changes. However, the requirements for supervisory review and approval of Third-Party Research Reports are not included in either of the SROs' joint memoranda regarding the SRO

[17] In this regard, we note that the Rule Filings include certain exceptions for research that a member firm makes available to its customers either upon request or through its website.

Rules. As noted above, we recognize that the SROs' rules governing communications with the public could literally be read to apply to Third-Party Research Reports. Nevertheless, the SROs' decision to address this issue through the addition of specific rule provisions regarding supervisory review and approval appears inconsistent with their position that the Rule Filings constitute "a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule." These aspects of the Rule Filings appear to be a significant policy change, particularly in light of NYSE's published interpretation of Rule 472. Accordingly, we believe these aspects of the Rule Filings were not properly designated by the SROs under Exchange Act Rule 19b-4(f)(1).

As noted above, most aspects of the Rule Filings are, in fact, codifications of existing interpretive guidance or are otherwise nonsubstantive and technical changes to the SRO Rules, and we support those changes. Despite our procedural concerns with the SROs' supervisory review and approval requirements, we are reluctant to suggest an abrogation of the Rule Filings that would eliminate those changes to the SRO Rules that were properly filed for immediate effectiveness. However, we strongly believe that the supervisory review and approval requirements should be subject to the public notice and comment process. As such, we believe that the Commission should consider instructing the SROs to withdraw these requirements and, after careful consideration of our comments, propose any rules regarding supervisory review and approval of Third-Party Research Reports under Section 19(b)(2) of the Exchange Act.

Conclusion

SIFMA reiterates its support for the overall goals of the Rule Filings but respectfully urges the Commission to carefully consider the procedural and substantive concerns we have set forth. In particular, we respectfully request that the Commission instruct the SROs to withdraw

the aspects of the Rule Filings regarding supervisory review and approval of Third-Party Research Reports and refile those changes with the Commission under Section 19(b)(2) of the Exchange Act so they are subject to the public notice and comment process. SIFMA would be happy to discuss any of its comments on the Rule Filings with the Commission or the Staff in greater detail. If you have any questions, please contact me at (212) 618-0509.

Sincerely

Michael D. Udoff
Vice President and Associate General Counsel

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Annette L. Nazareth, Commissioner
The Honorable Kathleen L. Casey, Commissioner

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