

Information Memo

Member Firm Regulation



NYSE Regulation, Inc. | 20 Broad Street
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ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS,
COMPLIANCE AND LEGAL DEPARTMENTS AND RESEARCH
DEPARTMENTS

TO: ALL MEMBER ORGANIZATIONS

SUBJECT: CODIFICATION OF INTERPRETATIONS TO RULE 472
(COMMUNICATIONS WITH THE PUBLIC)

Introduction

On September 27, 2006, the NYSE filed with the Securities Exchange Commission (“SEC” or “Commission”) for immediate effectiveness amendments to NYSE Rule 472 (“Communications With The Public” or the “Rule”).¹ This rule filing (the “Filing”) was done in coordination with the National Association of Securities Dealers (“NASD”), which made substantially similar changes to NASD Rule 2711. The amendments to Rule 472 codify existing NYSE interpretive guidance contained in previously circulated joint NYSE/NASD memoranda and make certain non-substantive, technical changes, where necessary, to clarify the rule's intended meaning. The Filing also codifies Exchange interpretations regarding the definition of “research report,” the distribution of third-party research reports through soft dollar arrangements and the requirements regarding the supervisory review and approval of third-party research reports, which were not contained in the joint memoranda. This Information Memo contains additional NYSE interpretations with respect to research analyst participation in pitch meetings and restrictions on sales and marketing activity.

As noted above, the amendments to the Rule were filed with the Commission for immediate effectiveness and, as such, the effective date was the date of filing, September 27, 2006.

Background

Since the 2002 amendments to Rule 472,² the NYSE has jointly published with NASD two memoranda that provide interpretive guidance to member organizations on a number of issues

¹ See Securities Exchange Act Release No. 54616 (October 17, 2006), 71 FR 62331 (October 24, 2006) (order approving SR-NYSE-2006-77 and SR-NASD-2006-112).

² See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) (order approving SR-NYSE-2002-09).

relating to the Rule and NASD's corresponding Rule 2711.³ Further, on December 21, 2005, the NYSE and the NASD submitted to the Commission a joint report on the operation and effectiveness of their respective Rules relating to research analyst conflicts of interest (the "SRO Report").⁴ Among the recommendations included in the SRO Report is that certain interpretations set forth in the two joint memoranda be codified as rule text. Accordingly, the NYSE filed amendments to NYSE Rule 472 consistent with these recommendations and made certain other changes based on other NYSE interpretations, which are discussed below.

Summary

Definition of "Public Appearance"

Prior to the Filing, NYSE Rule 472.50 defined "public appearance" as any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security. First, the Filing amends the definition of "public appearance" to codify existing interpretive guidance that "conference calls" are included in the definition.

Second, the amendments codify that a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security constitutes a "public appearance" only if presented before 15 or more persons. If a member organization can reasonably ascertain at a public speaking activity before 15 or more persons that those persons represent fewer than 15 separate investors, then it will not constitute a public appearance.

Third, the amendments clarify that any conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security before one or more representatives of the media constitutes a public appearance. This interpretation is consistent with the current definition of "public appearance," which expressly includes radio, television and print media interviews because the media are a conduit to the public.

Lastly, the amendments codify that password-protected Webcasts, conference calls and similar events with 15 or more existing customers (either individuals or entities) will not constitute a public appearance, provided that:

1. the event participants have previously received the most current research report or other documentation pertaining to the equity security in question that includes the disclosures required by Rule 472; and
2. the research analyst appearing at the event corrects or updates during the public appearance any disclosures that are inaccurate, misleading or no longer applicable.

³ See NYSE Information Memo 02-26 (June 26, 2002) and NYSE Information Memo 04-10 (March 9, 2004).

⁴ Joint Report by NASD and the NYSE on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules, December 2005, available at, <http://www.nyse.com/pdfs/rajointreport.pdf>.

Definition of “Research Report”

The amendments codify exclusions from the definition of “research report” in Rule 472.10(2) for certain communications.

The amendments exclude the following communications from the definition of "research report":

- (1) reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index;
- (2) reports commenting on economic, political or market conditions;
- (3) technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price;
- (4) statistical summaries of multiple companies' financial data, including listings of current ratings;
- (5) reports that recommend increasing or decreasing holdings in particular industries or sectors;
- (6) notices of ratings or price target changes, provided that the member organization simultaneously directs the readers of the notice to the most recent research report on the subject company that includes all current applicable disclosures required by NYSE Rule 472 and that such research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable.

Additionally, the amendments codify that the following communications are not included in the definition of "research report," even if they include an analysis of an individual security and information reasonably sufficient upon which to base an investment decision:

- (1) any communication distributed to fewer than 15 persons;
- (2) periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients that discuss individual securities in the context of a fund's or an account's past performance or the basis for previously made discretionary investment decisions;⁵ and
- (3) internal communications that are not given to customers.

Lastly, the amendments to the definition of “research report” codify an interpretation, not contained in the joint interpretive memoranda, that communications that constitute statutory prospectuses filed as part of a registration statement are not considered "research reports," even if they otherwise satisfy the definitional elements. This exemption recognizes that prospectuses serve different purposes than research reports and, thus, are subject to a separate comprehensive regulatory scheme.

Definition of “Investment Banking Services”

The amendments add “acting as a member of a selling group in a securities underwriting” to the definition of “investment banking services” in Rule 472.20.

⁵ Thus, for example, a manager's discussion of fund performance in a mutual fund shareholder report would not constitute a research report.

Definition of “Household Member”

The amendments clarify that the definition of “household member” in NYSE Rule 472.40 does not include an unrelated person who shares the same residence as a research analyst provided that the research analyst and unrelated person are financially independent of one another. Thus, for example, an analyst’s roommate or apartment mate, who is financially independent of the analyst, would not be considered a “household member” for purposes of the restrictions on personal trading and disclosure requirements in NYSE Rule 472.

Definition of “Equity Security”

Prior to the Filing, “equity security” was not defined in NYSE Rule 472. The amendments add “equity security” as a defined term in paragraph Rule 472.140 and codify that, for purposes of this rule, the term has the meaning ascribed to it in Section 3(a)(11)⁶ of the Securities Exchange Act of 1934.

Disclosure Requirements

NYSE Rule 472(k) sets forth a number of disclosure requirements for research reports and for public appearances by research analysts. Rule 472(k)(1)(i)g requires member organizations to disclose in research reports the percentage of all securities recommended by the member organization in each ratings category and the percentage in each ratings category of all subject companies that are investment banking clients of the member organization. Rule 472.70 supplements this provision providing that the ratings disclosures required under (k)(1)(i)g be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

The Filing amends NYSE Rule 472.70 to clarify that the ratings distribution in a research report should reflect the current distribution of the most recent ratings that the member organization has issued for all subject companies, within the previous 12 months. Thus, in a ratings distribution, a member organization only has to include ratings for subject companies for which it has issued a rating within the previous 12-month period.

In addition, the amendments clarify, in NYSE Rule 472(k)(1)(i)h, that a price chart is required only if a research report contains either a rating or a price target, and the member organization has assigned a rating or price target to the subject company for at least one year.

The amendments to NYSE Rule 472(k)(1) also explain that a research report must disclose: (1) the meanings of ratings used in the member organization's ratings system only if the report contains a rating of the subject company's stock; (2) the member organization's ratings distribution information only if the report contains a rating; and (3) valuation methods used in determining price targets only if the report contains a price target.

Compendium Reports

NYSE Rule 472(k)(1)(iii)d provides that when a member organization distributes a research report covering six or more companies, for purposes of the Rule’s disclosure requirements, such

⁶ 15 U.S.C. 78c(a)(11).

report may direct the reader in a clear manner to the applicable current disclosures in written or electronic format. Further, the amendments codify the existing NYSE interpretation that an electronic compendium report – a research report covering six or more subject companies – may include a hyperlink to the required disclosures. A paper-based compendium report must provide either a toll-free number to call or a postal address to write for the required disclosures and may also include a web address of the member organization where the disclosures can be found.

Third-Party Research

The Filing adds new provision (k)(4) (“Third-Party Research Reports”) which codifies Exchange interpretative guidance regarding the distribution of third-party research reports by member organizations. The amendments also codify the level of supervisory review and approval required of member organizations that distribute such reports.

- **Third-Party Research Report Disclosures**

The amendments codify interpretive guidance from the joint memoranda which provides that when a member organization distributes or makes available research produced by another member organization, a non-member organization affiliate (e.g., a foreign broker-dealer or an investment adviser) or an independent third party, the distributing member organization must disclose the following:

- 1) the distributing member organization's and its affiliate's ownership of the subject company's securities;
- 2) the distributing member organization's and its affiliate's investment banking relationships with the subject company;
- 3) the distributing member organization's market making activities in the subject company's securities; and
- 4) any other actual, material conflict of interest of the analyst or distributing member organization (the “third-party disclosures”).

Where a member organization distributes another member organization's research report, the distributing member organization must include the third-party disclosures only as they pertain to the distributing member organization's relationship to the subject company, whereas the preparing member organization is subject to all disclosure requirements under NYSE Rule 472.

- **Supervisory Review and Approval of Third-Party Research**

New section (k)(4) of Rule 472 also codifies the Exchange standard for supervisory review and approval of third-party research distributed by a member organization. This interpretation was not included in the joint memoranda but is based on the pre-Filing requirements of NYSE Rule 472 and its interpretation. Section (k)(4) supersedes the previous NYSE interpretation for “material externally prepared” in 472/07.⁷

⁷ The 472/07 interpretation pre-dates the SRO Research Analyst Conflict of Interest rule amendments. Subsequent to the approval of the SRO amendments, the Exchange conditioned regulatory relief, pursuant to 472/07, predicated on the inclusion of prescribed disclosures on third-party research reports, as required by Information Memos 02-26 and 04-10. In this regard, the inclusion of these third-party disclosures implied review of such reports by the distributing member organization. This standard for approval and review was codified in the Filing.

The supervisory requirements of NYSE Rule 472(a)(1) and 472.10 apply to all communications generally distributed or made available to customers or the public, which includes third-party research reports, pursuant to the broad definition of “communications” in Rule 472.10. The third-party disclosures and the supervisory review and approval requirements for third-party research only apply if third-party research is “distributed” by a member organization. A member organization is not considered to have “distributed” third-party research if it makes available non-affiliate (independent third-party) research on its website or upon customer request.

Rule 472(k)(4) requires that either a supervisory analyst or a person designated under Rule 342(b)(1)⁸ review third-party research distributed by a member organization to verify that the third-party disclosures, as they pertain to the distributing member organization, are complete and accurate. The distributing member organization is not required to verify the completeness or accuracy of the preparing entity’s disclosures when the preparing firm is an NASD or NYSE member organization.

Additionally, the distributing member organization must review the third-party research to ensure that the content of the research report is consistent with all applicable standards regarding communications with the public. This provision requires member organizations to meet the standard in Rule 472(i), which generally prohibits a member organization from distributing any third-party research that contains any untrue statement or omission of a material fact or is otherwise false or misleading.⁹

Rule 472(k)(4) also requires that all other content of the third-party research report distributed by a member organization be approved by a supervisory analyst qualified under NYSE Rule 344. A member organization is not required to validate the preparing firm’s methodologies, analysis or judgment.

- Soft Dollars

The joint NYSE and NASD interpretive memoranda indicate that distribution of independent third-party research through a soft-dollar arrangement is not encompassed by the disclosure requirements. The amendments to NYSE Rule 472 supersede this interpretation and provide that the third-party disclosure requirements do apply when a member organization distributes independent third-party research through a soft-dollar arrangement, unless another exception is available (e.g., where such research is provided upon customer request). The applicable disclosure and supervisory requirements apply equally to all third-party research distributed by a member organization, including soft dollar arrangements. But, as noted above, a member organization is not considered to have “distributed” such research, and thus the third-party research requirements will not apply, where non-affiliate (independent third party) research is made available to customers either upon request or through a member-maintained website, whether it is through a soft-dollar arrangement or otherwise.

⁸ E.g., a person who has taken and passed the Series 9/10, or another examination acceptable to the NYSE which demonstrates competency relevant to assigned responsibilities, including the Series 24 if taken and passed after July 1, 2001.

⁹ See also, NYSE Interpretation 472/08 which provides that, “All member organization communications are subject to the general standards set forth in Rule 472(i). The general standards prohibit the use of untruthful, misleading or inaccurate statements in any form of communication with the customers or the public, whether written or oral...”

Other Changes

The Exchange is also taking this opportunity to issue certain other interpretive guidance with respect to restrictions on sales and marketing activity and prohibitions on research analyst participation in pitch meetings.¹⁰

Prohibitions on Participation in Pitch Meetings

NYSE Rule 472(b)(5) prohibits research analysts from participating in pitch meetings. This provision is intended to prevent the use or promise of favorable research as a sales and marketing tool to influence prospective investment banking clients and to separate research analysts from sales and marketing activities.

NYSE interprets this provision to prohibit member organizations from including in pitch or presentation materials information regarding a research analyst employed by the firm or their views that suggests, directly or indirectly, that the member organization may provide favorable research. For example, the Exchange considers this prohibition to encompass pitch materials that include the industry ranking of an analyst. A member organization would be permitted to include in pitch materials the name of the research analyst and the fact of coverage, as long as it does not imply the potential for favorable research.¹¹

Restrictions on Sales and Marketing Activity

NYSE Rule 472(b)(6) prohibits research analysts from participating in road shows related to investment banking services transactions and from engaging in any communications regarding investment banking services transactions with current or prospective customers in the presence of investment banking personnel or company management. Investment banking personnel are also prohibited from directing research analysts to engage in sales or marketing efforts or to engage in any communication with a current or prospective customer related to investment banking transactions.

NYSE interprets this provision to permit research analysts to listen to (“listen-only” mode, not identified as being present), or view a live Webcast of a road show or other widely attended presentation to investors or the sales force, so long as access is from a remote location (*i.e.*, not at the same address as investment banking, investors or the sales force). Further, if the road show or other widely attended presentation to investors or the sales force is conducted at the member organization’s offices, research personnel may listen-in from the same address as investment banking, investors or the sales force, but not in the same room.

¹⁰ In the SRO Report, the NYSE expressed that these interpretations would likely be adopted and announced in a later Information Memo.

¹¹ Member organizations must consider whether the facts and circumstances of any solicitation or engagement would warrant disclosure under Section 17(b) of the Securities Act of 1933.

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Attachments