August 15, 2001

By letter and email to pubcom@nasd.com
Barbara Z. Sweeney
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1500

Re: NASD Notice to Members 01-45 - Request for Comment

Dear Ms. Sweeney:

Please accept this letter from the North American Securities Administrators Association[1], Inc. (NASAA) in response to NASD Notice to Members 01-45 - Request for Comment on proposed amendments to NASD Rule 2210 - Communications with the Public. NASAA has concerns with the objectivity of analysts' recommendations and applauds the initiative contained in the Notice to Members. As state regulators, our primary mission is to protect individual investors and we believe that this proposal enhances that protection. Therefore, NASAA generally supports the proposal.

NASAA has been closely monitoring the Congressional hearings focused on the issues surrounding conflicts of interest faced by brokerage firms and their analysts. Public confidence in the securities markets has been jeopardized because the analyst community has failed to disclose their conflicts of interest. Therefore, it is incumbent upon securities regulators to initiate action to eliminate the problem and restore confidence in the markets.

Our specific comments to the NASD proposal follow:

Disclosure of Financial Interest in Recommended Security

The first item in the proposal would require a person or persons responsible for a recommendation to disclose *any* financial interest that they have in a recommended security. NASAA fully endorses this item and believes that it is an essential first step to protect investors.

[1] The North American Securities Administrators Association, Inc. (NASAA) is the organization of state and provincial securities administrators representing all 50 states, 13 Canadian provinces and territories, the District of Columbia, Puerto Rico and Mexico.

The proposal asks for input as to "whether and to what extent the nature of that financial interest ... should be disclosed." As state securities regulators, we recommend that full and fair disclosure be given of any financial interest held in a recommended security by an analyst or agent. By "full and fair," we mean that the person with the responsibility for making the recommendation should disclose any and all relevant facts concerning his or her personal or financial interest in the security. Investors are entitled to know if a person recommending a security has an interest in the performance of that security and also have a reason to expect that fair dealing, as required of securities professionals, would require such disclosure.

To realize the maximum benefit from the rules, the NASD should take two additional steps. Acting Chairman Unger of the SEC recently testified before the Capital Markets Subcommittee, reporting that the SEC had found, on several occasions, analysts selling from their own account securities they were simultaneously recommending to their firms' customers for purchase. This, at a minimum, creates an appearance of impropriety. Under any circumstances, the analyst should be required to disclose that he or she is, or will be, selling the stock during the period for which the "buy" recommendation is in effect. The rule in this regard, should be broad enough to cover firm trading as well as analyst trading, and should also address short-selling prior to making negative recommendations, to cover all bases.

In recent years, state regulators have taken numerous enforcement actions against securities firms for false and fraudulent representations and dishonest and unethical sales practices. We have also encountered firms featuring primarily their own underwritings and compensating their analysts based on the size of the order flow in issuers favorably covered by the analyst. We recommend a rule to bar compensation to analysts based upon how often a security trades, particularly if the firm has an ownership or underwriter's interest in the issuer.

Finally, we also agree with the proposition that "[the] disclosure obligation also would apply to any discretionary account managed by the person or persons responsible for the recommendation."

Disclosure of Firm's Ownership of Recommended Securities

The NASD seeks comment concerning a requirement for member firms to disclose if they own five percent or more of the outstanding shares of any class of securities of the recommended issuer. NASAA believes this to be an important investor safeguard. The requirement should also extend to any "person," defined as anyone who is acting in the functional capacity of officer, director, principal, associated person, analyst or agent within the firm.

The NASD also requests comment on whether the ownership threshold that triggers a firm's duty to disclose ownership should be five percent or some other percentage. The proposal specifically mentions three percent or one percent as other possible thresholds.

We would note that the 5% threshold (which is consistent with Sections 13(d) and 13(g) of the Securities Exchange Act of 1934) may nonetheless be too high in this context. For large

cap companies, 5% of the shares represent an enormous amount of money.

Disclosure of Member Management of Issuer Public Offering

The third proposed amendment to Rule 2210 would eliminate the existing requirement to disclose that the member managed or co-managed within the last three years a public offering by the issuer of the recommended security. Instead, the proposal would require disclosure that the member has received compensation from the recommended issuer for any investment banking services provided to the issuer within the last 12 months. As noted in the proposal, the new requirement is intended to be broader in scope as to the type of activity covered by the amendment ("investment banking services" would include more kinds of activity than management or co-management of a public offering, while still including the latter activity), but would be shorter in time (12 months instead of three years).

We recommend that the broader scope as defined by the phrase "investment banking services" be adopted, but that the three-year time period be retained. The benefit this rule provides investors is to inform them if their broker has an ongoing investment banking relationship with an issuer and any attendant bias that relationship may imply. A three-year look back is much more likely to expose such a relationship than a mere 12 months.

The proposal asks for comment on whether "in addition to disclosure of an 'investment banking relationship', members should be required to describe the specific nature of the services for which compensation has been received from the issuer within the prior [three years]." We believe that disclosure of the nature of the services for which compensation has been received is very important. We would prefer that the NASD propose and adopt specific guidelines as to what should be disclosed.

Steps should also be taken to prevent a member or an analyst touting a security or the quality or value of their investment banking business under the guise of disclosing the "specific nature of the services."

The disclosure requirement also needs to be sufficiently balanced and flexible so that a member firm or an analyst is not required to describe the specific nature of the services in such detail that it leaks non-public information. By example, it would be unreasonable to force a firm to disclose that it was compensated for investment banking services within the last three years on a pending, but not yet public, merger or acquisition of the recommended company, or any of its subsidiaries or divisions.

Specific and Prominent Disclosures

The next item would mandate that all required disclosures be specifically and prominently displayed in advertisements and sales literature. This is intended to inform investors about real or potential conflicts of interest. We support this proposal and endorse the reasons enumerated in the Notice to Members.

Public Appearance Disclosures

The proposal would amend the section of the rule dealing with disclosures during public appearances. Specifically, the proposal would require analysts speaking in public to provide similar disclosures to those above. The amendment would require associated persons who make recommendations during public appearances to disclose any financial interest held by that person, any discretionary account he or she manages, ownership by the firm of five percent or more of the total outstanding shares of any class of equity securities [of] the issuer, and that the issuer is "a client of the firm with which the [person recommending the security] is associated."

NASD specifically seeks comment on whether disclosures in a public appearance should be broader or should include one or more of the six disclosures in current NASD Rule 2210(d)(2)(B). In addition, the current proposal as it applies to public appearances would not require disclosure of the nature of the investment services provided. NASD solicits comments on whether the nature of the services provided should be disclosed in public appearances. NASAA appreciates that there are practical constraints imposed upon public appearances in comparison to written materials provided by the firm.

We have several recommendations concerning the requirements under the rule for disclosures at public appearances. As a general proposition, all six disclosures in current rule, 2210(d)(2)(B) should be the goal. This is of course impossible in the context of a short interview. We would recommend that the NASD propose specific guidelines for various time scenarios. That is, if the public appearance is an hour-long presentation to a group, the NASD should state what should be disclosed and how detailed that disclosure should be relative to the length of the appearance. As state regulators, we prefer efficient, effective disclosure. If the public appearance is a ten-second sound bite on television, there won't be time for detailed disclosure. Clearly, a different standard should apply for these two extremes. Obviously, there are other time scenarios. We would recommend that the NASD provide detailed examples of various scenarios and set standards for each of them.

On the issue of whether disclosures at public appearances should be oral or in writing, if the presentation is solely oral, the disclosure should be oral (at least). If the presentation includes written hand-outs or other material, the disclosure should be both oral and written. In either case, the disclosure should be "specific and prominent" and accurately alert the investor to any potential or real biases or conflicts of interest.

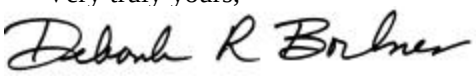
Conclusion

NASAA is also concerned about a closely related issue of disclosure which we hope the NASD will at some time address. Typically, an analyst, or the firm itself, will announce a "price target" for a stock implying that when the target is reached the stock will be fully valued. When the market is rising rapidly, as it was in 1999 and early 2000, price targets were being crashed through in days or weeks after they were announced. Almost universally, no "sell"

recommendations were generated by these events. Instead new, higher targets were quietly installed with no explanation why the analyst believed a company to be worth 40% more this week than last. If price targets are to be used as part of an analyst's recommendation, when a target is met the analyst should disclose why his or her recommendation didn't change to "sell". Otherwise, the use of target prices can be materially misleading to investors.

NASAA commends the NASD for moving forward with proposals to strengthen disclosures by research analysts and we appreciate the opportunity to comment on them. NASAA stands ready to work with you as you consider additional policies in this area to enhance investor protection. In this regard, please contact me at (360) 902-8797 or Franklin Widmann, NASAA Broker-Dealer Section Chair at (973) 504-3610.

Very truly yours,



Deborah Bortner
NASAA President