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Page 1 of * 423	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2014 - * 047 Amendment No. (req. for Amendments *)
Filing by Financial Industry Regulatory Authority Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934		
Initial * <input checked="" type="checkbox"/> Amendment * <input type="checkbox"/> Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/> Section 19(b)(3)(A) * <input type="checkbox"/> Section 19(b)(3)(B) * <input type="checkbox"/>	Rule <input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(3) <input type="checkbox"/> 19b-4(f)(6)
Pilot <input type="checkbox"/> Extension of Time Period for Commission Action * <input type="checkbox"/> Date Expires *	Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/> Section 806(e)(2) * <input type="checkbox"/> Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>	
Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>	
Description Provide a brief description of the action (limit 250 characters, required when Initial is checked *). <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook </div>		
Contact Information Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action. <div style="margin-top: 20px;"> First Name * Philip Last Name * Shaikun Title * Vice President and Associate General Counsel E-mail * philip.shaikun@finra.org Telephone * (202) 728-8451 Fax (202) 728-8264 </div>		
Signature Pursuant to the requirements of the Securities Exchange Act of 1934, has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized. <div style="text-align: center; margin-top: 10px;"> (Title *) </div> <div style="display: flex; justify-content: space-between; margin-top: 10px;"> <div> Date 11/14/2014 By Patrice Gliniecki (Name *) </div> <div style="border: 1px solid black; padding: 5px; width: 60%;"> Senior Vice President and Deputy General Counsel <div style="text-align: center; margin-top: 10px;"> Patrice Gliniecki, </div> </div> </div> <p style="font-size: small; margin-top: 10px;">NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.</p>		

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFT website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to adopt NASD Rule 2711 (Research Analysts and Research Reports) as a FINRA rule, with several modifications. The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 to create an exception from the research analyst qualification requirement. The proposed rule change would renumber NASD Rule 2711 as FINRA Rule 2241 in the consolidated FINRA rulebook.

The text of the proposed rule change is attached as Exhibit 5 to this rule filing.

(b) Upon Commission approval and implementation by FINRA of the proposed rule change, corresponding NASD Rule 2711 and the corresponding provisions of Incorporated NYSE Rule 472 and its interpretations will be eliminated from the current FINRA rulebook.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

At its meeting on February 10, 2010, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission

¹ 15 U.S.C. 78s(b)(1).

approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

As part of the process of developing a new consolidated rulebook (“Consolidated FINRA Rulebook”),² FINRA is proposing to adopt in the Consolidated FINRA Rulebook NASD Rule 2711 (Research Analysts and Research Reports) with several modifications as FINRA Rule 2241. The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) to create an exception from the research analyst qualification requirements.

Background

NASD Rule 2711 and Incorporated NYSE Rule 472 (Communications with the Public) (“the Rules”) set forth requirements to foster objectivity and transparency in equity research and provide investors with more reliable and useful information to make investment decisions. The Rules were intended to restore public confidence in the objectivity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell those

² The current FINRA rulebook includes, in addition to FINRA Rules, (1) NASD Rules and (2) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

issuers' securities. The integrity of research had eroded due to the pervasive influences of investment banking and other conflicts that became apparent during the market boom of the late 1990s.

The current NASD and Incorporated NYSE rules have no significant differences.³ In general, the Rules require disclosure of conflicts of interest in research reports and public appearances by research analysts. The Rules further prohibit conflicted conduct – investment banking personnel involvement in the content of research reports and determination of analyst compensation, for example – where the conflicts are too pronounced to be cured by disclosure. Several of the Rules' provisions implement provisions of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which mandates separation between research and investment banking, proscribes conduct that could compromise a research analyst's objectivity and requires specific disclosures in research reports and public appearances.⁴

NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) require any person associated with a member and who functions as a research analyst to be registered as such and pass the Series 86 and 87 exams, unless an exemption applies. NASD Rule 1050 defines "research analyst" as "an associated person who is primarily responsible for the

³ The one substantive difference between the rules involves the recordkeeping obligations when a research analyst makes a public appearance. Incorporated NYSE Rule 472(k)(2) requires a record of the public appearance to be made within 48 hours and include specific information about the nature of the appearance and applicable disclosures. NASD Rule 2711(h)(12) provides that members must maintain records of public appearances sufficient to demonstrate compliance with the applicable disclosure requirements.

⁴ 15 U.S.C. 78o-6.

preparation of the substance of a research report or whose name appears on a research report.” Incorporated NYSE Rule 344 has a substantially similar definition.

In December 2005, in response to a Commission Order, FINRA and the NYSE submitted to the Commission a joint report on the operation and effectiveness of the research analyst conflict of interest rules (“Joint Report”).⁵ Among other things, the Joint Report analyzed the impact of the Rules based on academic studies, media reports and commentary. The Joint Report concluded that the Rules have been effective in helping to restore integrity to research by minimizing the influence of investment banking and promoting transparency of other potential conflicts of interest. Evidence from academic studies, among other sources, further suggested that investors are benefiting from more balanced and accurate research to aid their investment decisions. A January 2012 GAO report on securities research (“GAO Report”) also concluded that empirical results suggest the Rules have resulted in increased analyst independence and weakened the influence of conflicts of interest on analyst recommendations.⁶

The Joint Report also recommended changes to the Rules to strike an even better balance between ensuring objective and reliable research on the one hand, and permitting the flow of information to investors and minimizing costs and burdens to members on the

⁵ 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.finra.org/web/groups/industry/@ip/@issues/@rar/documents/industry/p015803.pdf>.

⁶ United States Government Accountability Office, Securities Research, Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest, January 2012.

other.⁷ The recommendations resulted from a comprehensive review of the Rules. In evaluating the Rules, FINRA staff considered several analytical touchstones: whether a provision was accomplishing its intended purpose; findings from examinations, sweeps and enforcement actions; interpretive requests and member questions; a comparison of provisions of the “Global Settlement”;⁸ potential gaps or overbreadth in the provisions; and input from members and industry groups. The proposed rule change maintains those aforementioned objectives and therefore incorporates many of the recommendations in the Joint Report not already incorporated into the current rules.⁹

⁷ FINRA previously filed two proposed rule changes to implement recommendations from the Joint Report. On October 17, 2006, FINRA filed for immediate effectiveness a proposed rule change to codify previously issued interpretive guidance. See Securities Exchange Act Release No. 54616 (October 17, 2006), 71 FR 62331 (October 24, 2006) (Notice of Filing File Nos. SR-NYSE-2006-77; SR-NASD-2006-112). However, FINRA withdrew the second proposal in anticipation of filing this more comprehensive consolidated proposed rule change. See Securities Exchange Act Release No. 55072 (January 9, 2007), 72 FR 2058 (January 17, 2007) (Notice of Filing File Nos. SR-NYSE-2006-78; SR-NASD-2006-113) (Withdrawn October 25, 2012).

⁸ In 2003, federal and state authorities and self-regulatory organizations reached a settlement with 10 of the nation’s largest broker-dealers to resolve allegations of misconduct involving conflicts of interest between their research analysts and investment bankers. In 2004, two additional firms settled substantively under the same terms, which included provisions to effectively separate research from investment banking.

⁹ FINRA has not incorporated all of the Joint Report recommendations in the proposed rule change. As discussed infra at 72, FINRA is not incorporating the recommendation to exclude direct participation programs from the definition of “research report.” FINRA previously addressed a recommendation to provide guidance with respect to the road show prohibition. FINRA set forth guidance in Regulatory Notice 07-04 that it is permissible for research analysts to listen to or view a live webcast of a road show or other widely attended presentation to investors or the sales force from a remote location. That guidance remains applicable to the proposed rule change. As discussed infra at 21, FINRA is not incorporating the recommendation to completely eliminate the quiet period after secondary offerings. FINRA also is not incorporating the recommendation to

The proposed rule change would retain the core provisions of the current rules, broaden the obligations on members to identify and manage research-related conflicts of interest, restructure the rules to provide some flexibility in compliance without diminishing investor protection, extend protections where gaps have been identified, and provide clarity to the applicability of existing rules. Where consistent with protection of users of research, the proposed rule change reduces burdens: for example, it would modify or eliminate requirements (e.g., quiet periods and the annual attestation), expand the exemption for firms with limited investment banking activity, and create a new limited exemption from the registration requirements for “research reports” produced by persons whose primary job function is something other than producing research. Taken together, FINRA believes the proposed amendments will result in rules that more effectively and efficiently achieve their intended goals of objective, transparent and useful research for investors. The proposed rule change reflects input from FINRA advisory committees and market participants and includes changes made in response to comments received to an earlier consolidated rule proposal set forth in Regulatory Notice 08-55. The substantive proposed changes to the existing research rules are described below.¹⁰

expand the exceptions to the personal trading restrictions because, as discussed infra at 27, FINRA is proposing to replace the prescriptive restrictions with a requirement to establish, maintain and enforce policies and procedures that obviate the need to set out specific exceptions to those provisions. In addition, as discussed infra at 34-35, FINRA is not proposing to replace the current disclosure requirements with a prominent warning on the cover of a research report that conflicts of interest exist, together with information on how the reader may obtain more detail about the conflicts on the member’s website.

¹⁰ For economy, the discussion generally refers only to NASD Rules; however, those references apply equally to the corresponding Incorporated NYSE Rules.

Definitions

The proposed rule change mostly maintains the definitions in current NASD Rule 2711, with the following modifications:

- minor changes to the definition of “investment banking services” to clarify that such services include all acts in furtherance of a public or private offering on behalf of an issuer.¹¹
- clarification in the definition of “research analyst account” that the definition does not apply to a registered investment company over which a research analyst has discretion or control, provided that the research analyst or a member of that research analyst’s household has no financial interest in the investment company, other than a performance or management fee.¹²
- exclusion from the definition of “research report” of communications concerning open-end registered investment companies that are not listed or traded on an exchange (“mutual funds”).¹³

¹¹ See proposed FINRA Rule 2241(a)(5). The current definition includes, without limitation, many common types of investment banking services. FINRA is proposing to add the language “or otherwise acting in furtherance of” either a public or private offering to further emphasize that the term “investment banking services” is meant to be construed broadly.

¹² See proposed FINRA Rule 2241(a)(9).

¹³ See proposed FINRA Rule 2241(a)(11).

- move into the definitional section the definitions of “third-party research report” and “independent third-party research report” that are now in a separate provision of the rules.¹⁴

The current rules define “research analyst account” to include any account over which a research analyst or member of the research analyst’s household has a financial interest, or over which such person has discretion or control, other than an investment company registered under the Investment Company Act of 1940. The purpose of the exception is to accommodate circumstances where a research analyst also manages a registered investment company; otherwise, every transaction in the investment company’s fund would be subject to personal trading restrictions, including any blackout periods a firm may establish, creating substantial logistical difficulties in operating the fund. The proposed change is intended to clarify that the exception does not apply where the research analyst account has a financial interest in the fund, other than a performance or management fee. In those circumstances, FINRA believes the conflict is too serious because the research analyst account could benefit more directly by taking positions in advance of publishing research or making a public appearance that could affect the price of the holdings.

“Research report” currently is defined in Rule 2711(a)(9) as a “written (including electronic) communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.” Since shares of mutual funds are “equity securities” as

¹⁴ See proposed FINRA Rules 2241(a)(3) and (13). FINRA believes it creates a more streamlined and user friendly rule to combine defined terms in a single definitional section.

defined in Section 3(a)(11) of the Exchange Act, a written communication that contains an analysis of mutual fund securities and information sufficient upon which to base an investment decision technically is covered by the definition.

However, FINRA believes that communications concerning mutual funds should be excluded from the definition of “research report.” Sales material regarding mutual funds is already subject to a separate regulatory regime, including FINRA Rule 2210 and Securities Act of 1933 (“Securities Act”) Rule 482, and, subject to certain exceptions, retail communications regarding registered investment companies must be filed with FINRA within 10 business days of first use.¹⁵ The extensive content standards of these rules, combined with the filing and review of mutual fund sales material by FINRA staff, substantially reduce the likelihood that such material will include materially misleading information about the funds. Moreover, FINRA does not believe that the conflicts underpinning the research rules are manifest to the same extent with respect to reports on mutual funds. For example, a mutual fund’s share price is determined by the fund’s net asset value (“NAV”), which is based on the total value of the fund’s portfolio. Because

¹⁵ See FINRA Rule 2210(c)(3)(A). A retail communication concerning a registered investment company that includes a performance ranking or performance comparison of the investment company with other investment companies that is not generally published or is created by the fund or its affiliates must be filed with FINRA at least 10 business days prior to first use or publication. FINRA Rule 2210(c)(7) lists categories of member communications that are excluded from the rule’s filing requirements, including certain retail communications concerning investment companies. For example, FINRA Rule 2210(c)(7)(I) excludes from the rule’s filing requirements certain independently prepared reprints or excerpts of articles or reports concerning investment companies. However, this filing exclusion only applies to articles or reports where the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint, and neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article or report.

most mutual funds hold a large number of individual securities, it is much less likely that a report on a mutual fund would affect the fund's NAV to the same extent that a research report on a single stock might impact its share price.

Identifying and Managing Conflicts of Interest

The proposal creates a new section entitled "Identifying and Managing Conflicts of Interest." This section contains an overarching provision that requires members to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts and the interaction between research analysts and persons outside of the research department, including investment banking and sales and trading personnel, the subject companies and customers.¹⁶ A second provision sets forth more specifically what those written policies and procedures must address. They must promote objective and reliable research that reflects the truly held opinions of research analysts and prevent the use of research or research analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers.¹⁷ These provisions, therefore, set out the fundamental obligation for a member to establish and maintain a system to identify and mitigate conflicts to foster integrity and fairness in its research products and services. The provisions are also intended to require firms to be more

¹⁶ See proposed FINRA Rule 2241(b)(1).

¹⁷ See proposed FINRA Rule 2241(b)(2).

proactive in identifying and managing conflicts as new research products, affiliations and distribution methods emerge.

The proposed rule change then sets forth minimum requirements for those written policies and procedures. This approach allows for some flexibility to manage identified conflicts, with some specified prohibitions and restrictions where disclosure does not adequately mitigate them. Most of the minimum requirements have been experience tested and found effective.

Sarbanes-Oxley mandates specific rules to prohibit or restrict conduct related to the preparation, approval and distribution of research reports and the determination of research analyst compensation. Thus, the proposal requires members to establish, maintain and enforce written policies and procedures reasonably designed specifically to achieve compliance with those Sarbanes-Oxley requirements. This approach provides firms with more flexibility to adopt policies and procedures to effectuate those mandates in a manner consistent with the member's size and organizational structure. The proposed rule changes also goes beyond Sarbanes-Oxley to require additional written policies and procedures that further the separation between research and not only investment banking, but also other non-research personnel, such as sales and trading, that may have interests that conflict with independent, unbiased research.

Thus, the proposed rule change mostly retains or slightly modifies the current structural safeguards that the Joint Report found effective to promote analyst independence and objective research, but in the form of mandated written policies and

procedures with some baseline proscriptions.¹⁸ FINRA believes this approach will provide the same investor protections as the current rules, but impose less cost than a pure prescriptive approach by requiring firms to adopt a compliance system that aligns with their particular structure, business model and philosophy. FINRA notes that the approach is consistent with FINRA's general supervision rule, which similarly provides firms flexibility to establish and maintain supervisory programs best suited to their business models, reasonably designed to achieve compliance with applicable federal securities law and regulations and FINRA rules.¹⁹

¹⁸ Among the structural safeguards, FINRA believes separation between investment banking and research is of particular importance. As such, while the proposed rule change does not mandate physical separation between the research and investment banking departments (or other person who might seek to influence research analysts), FINRA would expect such physical separation except in extraordinary circumstances where the costs are unreasonable due to a firm's size and resource limitations. In those instances, a firm must implement written policies and procedures, including information barriers, to effectively achieve and monitor separation between research and investment banking personnel.

¹⁹ See NASD Rule 3010, recently adopted with changes as a consolidated FINRA rule by Securities Exchange Act Release No. 71179 (December 23, 2013), 78 FR 79542 (December 30, 2013) (Order Approving File No. SR-FINRA-2013-025). The consolidated rule becomes effective December 1, 2014. FINRA further notes that the policies and procedures approach is consistent with the effective practices highlighted by FINRA in its Report on Conflicts of Interest, among them that firms should implement a robust conflicts management framework that includes structures, processes and policies to identify and manage conflicts of interest. See Report on Conflicts of Interest, FINRA (October 2013) at 5, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf>. The proposed changes also help to harmonize with approaches in international jurisdictions, such as the rules of the Financial Conduct Authority in the United Kingdom. See COBS 12.2.5 R, The Financial Conduct Authority Handbook, available at <http://fshandbook.info/FS/html/handbook/COBS/12/2>.

Prepublication Review

The required policies and procedures must, at a minimum, be reasonably designed to prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel.²⁰ Thus, this provision maintains the current prohibition on prepublication review by investment banking personnel, but eliminates the exception in paragraph (b)(3) of Rule 2711 that permits pre-publication review of research by investment banking to verify the factual accuracy of information in a research report. FINRA believes that review of facts in a report by investment banking is unnecessary in light of the numerous other sources available to verify factual information, including the subject company, and only raises concerns about the objectivity of the report. Such review may invite pressure on a research analyst from such personnel that could be difficult to monitor. Factual review by investment banking personnel is not permitted under the terms of the Global Settlement, and FINRA staff is not aware of any evidence that the factual accuracy of research produced by Global Settlement firms has suffered. Moreover, legal and compliance can adequately perform a conflict review without sharing draft research reports with investment banking.

The proposal requires policies and procedures reasonably designed to at least restrict prepublication review by other non-research personnel, other than legal and compliance personnel. Thus, a firm must specify in its policies and procedures the

²⁰ See proposed FINRA Rule 2241(b)(2)(A).

circumstances, if any, where such review would be permitted as necessary and appropriate; for example, where non-research personnel are best situated to verify select facts or where administrative personnel review for formatting. FINRA notes that members still would be subject to the overarching requirement to have policies and procedures reasonably designed to effectively manage conflicts of interest between research analysts and those outside of the research department.

Coverage Decisions

The required policies and procedures must be reasonably designed to restrict or limit input by investment banking department into research coverage decisions to ensure that research management independently makes all final decisions regarding the research coverage plan.²¹ This provision makes express FINRA's interpretation that the separation requirements in current Rule 2711(b)(1) prohibit investment banking personnel from making any final coverage decisions. The proposed provision does not preclude investment banking personnel from conveying customer interests or providing input into coverage considerations, so long as final decisions regarding the coverage plan are made by research management.

Supervision and Control of Research Analysts

The required policies and procedures must be reasonably designed to prohibit persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination.²² The provision is substantively the same as current Rule 2711(b)(1),

²¹ See proposed FINRA Rule 2241(b)(2)(B).

²² See proposed FINRA Rule 2241(b)(2)(C).

a core structural separation requirement that FINRA believes is essential to safeguarding analyst objectivity.

Research Budget Determinations

The required policies and procedures must be reasonably designed to limit determination of research department budget to senior management, excluding senior management engaged in investment banking services activities.²³ This provision makes express FINRA's interpretation that the separation requirements of current Rule 2711(b)(1) prohibit investment banking personnel from making any determination of research budget decisions.

Compensation

The required policies and procedures must be reasonably designed to prohibit compensation based upon specific investment banking services transactions or contributions to a member's investment banking services activities.²⁴ The policies and procedures further must require a committee that reports to the member's board of directors – or if none exists, a senior executive officer – to review and approve at least annually the compensation of any research analyst who is primarily responsible for preparation of the substance of a research report. The committee may not have representation from a member's investment banking department. The committee must consider, among other things, the productivity of the research analyst and the quality of his or her research and must document the basis for each research analyst's

²³ See proposed FINRA Rule 2241(b)(2)(D).

²⁴ See proposed FINRA Rule 2241(b)(2)(E).

compensation.²⁵ These provisions are consistent with the requirements in current Rule 2711(d).

Information Barriers

The required policies and procedures must be reasonably designed to establish information barriers or other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision.²⁶ FINRA believes the other policies and procedures required by the proposed rule change to identify and manage research-related conflicts of interest should effectively result in compliance with this Sarbanes-Oxley-based provision. However, FINRA is including the provision to emphasize that the conflicts management must extend to persons other than investment banking personnel, including sales and trading department personnel, who may be placed in a position to supervise or influence the content of research reports or public appearances.

Retaliation

The required policies and procedures must be reasonably designed to prohibit direct or indirect retaliation or threat of retaliation against research analysts employed by the member or its affiliates by persons engaged in investment banking services activities or other employees as the result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may

²⁵ See proposed FINRA Rule 2241(b)(2)(F).

²⁶ See proposed FINRA Rule 2241(b)(2)(G).

adversely affect the member's present or prospective business interests.²⁷ This provision is consistent with current Rule 2711(j), except that it extends the retaliation prohibition to employees other than investment banking personnel. FINRA believes it is essential to a research analyst's independence and objectivity that no person employed by a member that is in a position to retaliate or threaten to retaliate should be permitted to do so based on the content of a research report or public appearance.

Quiet Periods

The required policies and procedures must be reasonably designed to define quiet periods of a minimum of 10 days after an initial public offering, and a minimum of three days after a secondary offering, during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer if the member has participated as an underwriter or dealer in the initial public offering or, with respect to the quiet periods after a secondary offering, as a manager or co-manager of that offering.²⁸ This provision represents a significant change from the current rules, which impose a 40-day quiet period on a member acting as manager or co-manager of an IPO, a 25-day quiet period on a member participating as an underwriter or dealer (other than manager or co-manager) in an IPO, and a 10-day quiet

²⁷ See proposed FINRA Rule 2241(b)(2)(H). This provision is not intended to limit a member's authority to discipline or terminate a research analyst, in accordance with the member's written policies and procedures, for any cause other than writing an adverse, negative, or otherwise unfavorable research report or for making similar comments during a public appearance.

²⁸ See proposed FINRA Rule 2241(b)(2)(I). Consistent with the Jumpstart Our Business Startups Act ("JOBS Act"), those quiet periods do not apply following the IPO or secondary offering of an Emerging Growth Company ("EGC"), as that term is defined in Section 3(a)(80) of the Exchange Act.

period on a member acting as manager or co-manager of a secondary offering. As mentioned above, the quiet periods do not apply to EGCs.

With respect to these quiet-period provisions, the proposed rule change reduces the current 40-day quiet period for IPOs to a minimum of 10 days after the completion of the offering for any member that participated as an underwriter or dealer, and reduces the 10-day secondary offering quiet period to three days after the completion of the offering for any member that participated as a manager or co-manager in the secondary offering.

The lengthier quiet period for managers and co-managers was intended to allow other voices to publicly analyze and value a subject company before members most vested in the success of the offering expressed a view in their reports and public appearances. However, in light of the objectivity safeguards in other provisions of the research rules and the certification requirement of SEC Regulation AC, FINRA believes it is no longer necessary to impose a longer period on managers and co-managers. Both the Joint Report and the GAO Report noted that analysts have been issuing less optimistic recommendations since the regulatory reforms, particularly at firms involved in underwriting subject company securities.²⁹ FINRA believes that the separation, disclosure and certification requirements in the rules and Regulation AC have had greater impact on the objectivity of research than maintaining quiet periods during which research may not be distributed and research analysts may not make public appearances. FINRA has observed – and media reports have documented – instances when a manager or co-manager of an IPO has initiated coverage of the subject company with a “hold” or

²⁹ See Joint Report, supra note 5 at 17-20; see GAO Report, supra note 6 at 12-15.

even “sell” rating once the quiet period ended.³⁰ These examples buttress FINRA’s belief that the other provisions of the rules and Regulation AC have been effective in deterring biased research. FINRA also notes that there is a cost to investors when they are deprived of information and analysis during quiet periods.

Accordingly, FINRA is proposing to reduce all of the quiet periods after IPOs and secondary offerings. By doing so, FINRA believes the proposed rule change would promote more information flow to investors without jeopardizing the objectivity of research. As reflected in the Joint Report, FINRA was in favor of completely eliminating the quiet periods around secondary offerings; however, SEC staff has since indicated its view that the Sarbanes-Oxley reference to “public offering of securities”³¹ encompasses both initial public offerings and secondary offerings and therefore mandates a quiet period after such public offerings, except for EGCs. FINRA will read with interest comments with evidence that suggests that maintaining longer quiet periods for manager and co-managers after the IPO of a non-EGC issuer would provide a meaningful benefit to investors.

As recommended in the Joint Report, the proposed rule change also eliminates the current quiet periods 15 days before and after the expiration, waiver or termination of a lock-up agreement. FINRA believes that research issued during such periods potentially offers valuable market information, and the other provisions of the research rules and

³⁰ See Facebook Shares No Lock for Pop After Quiet Period, available at <http://blogs.wsj.com/marketbeat/2012/06/27/facebook-shares-no-lock-for-pop-after-quiet-period/>; see also Warburg Analyst Advises Investors to Sell JetBlue, available at <http://articles.latimes.com/2002/may/08/business/fi-wrap8>.

³¹ 15 U.S.C 78o-6(a)(2).

SEC Regulation AC provide sufficient protection that such research will reflect the analyst's honest beliefs and be free from other conflicts that would undermine the value or integrity of research issued during these periods. FINRA understands from some underwriters that issuers will time release of negative news to occur during these quiet periods, thereby depriving investors of timely analysis of the impact of the news on their holdings. FINRA also notes that the change will bring consistency to the application of the rules, irrespective of the subject company, because, as noted above, recent amendments implementing the JOBS Act exempt research regarding EGCs from the current quiet periods.³²

Solicitation and Marketing

In addition, the proposed rule change requires firms to adopt written policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity.³³ This includes the existing prohibitions on participation in pitches and other solicitations of investment banking services transactions and road shows and other marketing on behalf of issuers related to such transactions. FINRA notes that consistent with existing guidance analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.³⁴

³² FINRA notes that the proposed changes to the quiet periods do not affect any quiet periods that may be required under federal law.

³³ See proposed FINRA Rule 2241(b)(2)(L).

³⁴ See NASD Notice to Members 07-04 (January 2007) and NYSE Information Memo 07-11 (January 2007).

Pursuant to the recent amendments implementing the JOBS Act, the prohibition on participation in pitch meetings does not apply to a research analyst that attends a pitch meeting in connection with an IPO of an EGC that is also attended by investment banking personnel. However, FINRA notes that research analysts still are prohibited from soliciting an investment banking services transaction or promising favorable research during permissible attendance at those pitch meetings.³⁵ The proposed rule change also adds Supplementary Material .01, which codifies the existing interpretation that the pitch provision prohibits members from including in pitch materials any information about a member's research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage.³⁶ By way of example, the Supplementary Material explains that FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. The Supplementary Material further notes that a member would be permitted to include in the pitch materials the fact of coverage and the name of the research analyst, since that information alone does not imply favorable coverage.

Joint Due Diligence and Other Interactions with Investment Banking

The proposed rule establishes a new proscription with respect to joint due diligence activities – i.e., due diligence by the research analyst in the presence of

³⁵ See Jumpstart Our Business Startups Act, Frequently Asked Questions About Research Analysts and Underwriters, available at <http://www.sec.gov/divisions/marketreg/tmjjobsact-researchanalystsfaq.htm>.

³⁶ See proposed FINRA Rule 2241.01 and Notice to Members 07-04 (January 2007).

investment banking department personnel – during a specified time period. Specifically, proposed Supplementary Material .02 states that FINRA interprets the overarching principle requiring members to, among other things, establish, maintain and enforce written policies and procedures that address the interaction between research analysts, banking and subject companies, to prohibit the performance of joint due diligence prior to the selection of underwriters for the investment banking services transaction. FINRA understands that in some instances, due diligence activities take place even before an issuer has awarded the mandate to manage or co-manage an offering. FINRA believes there is heightened risk in those circumstances that investment bankers may pressure analysts to produce favorable research that may bolster the firm's bid to become an underwriter for the offering. Once the mandate has been awarded, FINRA believes joint due diligence may take place in accordance with appropriate policies and procedures to guard against interactions to further the interests of the investment banking department. At that time, FINRA believes that the efficiencies of joint due diligence outweigh the risk of pressure on research analysts by investment banking. Also, FINRA understands that typically an analyst that is participating in due diligence activities will not be publishing research at that time due to quiet periods under the offering rules of the Securities Act or because the analyst has been brought "over the wall." FINRA notes that this provision is consistent with restrictions in the Global Settlement.

The proposed rule continues to prohibit investment banking department personnel from directly or indirectly directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction, and directing a research analyst to engage in any communication with a current or prospective customer about an

investment banking services transaction.³⁷ Supplementary Material .03 clarifies that three-way meetings between research analysts and a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction are prohibited by this provision.³⁸ FINRA believes that the presence of investment bankers or issuer management could compromise a research analyst's candor when talking to a current or prospective customer about a deal. Supplementary Material .03 also retains the current requirement that any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

Promises of Favorable Research and Prepublication Review by Subject Company

The proposal maintains the current prohibition against promises of favorable research, a particular research recommendation, rating or specific content as inducement for receipt of business or compensation.³⁹ It further prohibits prepublication review of a

³⁷ See proposed FINRA Rule 2241(b)(2)(M). FINRA notes that this provision does not prohibit investment banking personnel from forwarding to a research analyst the name of a prospective investor in an investment banking transaction, provided that the research analyst retains discretion whether to contact the investor and for the content of any discussion that ensues. See Regulatory Notice 12-49 (November 2012).

³⁸ See proposed FINRA Rule 2241.03.

³⁹ See proposed FINRA Rule 2241(b)(2)(K). FINRA provided additional guidance on the current provision, NASD Rule 2711(e), in Regulatory Notice 11-41 (September 2011).

research report by a subject company for purposes other than verification of facts.⁴⁰

Supplementary Material .05 maintains the current guidance applicable to the prepublication submission of a research report to a subject company. Specifically, sections of a draft research report may be provided to non-investment banking personnel or the subject company for factual review, provided: (1) that the draft section does not contain the research summary, research rating or price target; (2) a complete draft of the report is provided to legal or compliance personnel before sections are submitted to non-investment banking personnel or the subject company; and (3) any subsequent proposed changes to the rating or price target are accompanied by a written justification to legal or compliance and receive written authorization for the change. The member also must retain copies of any draft and the final version of the report for three years.⁴¹

Personal Trading Restrictions

The proposal provides for a more encompassing and flexible supervisory approach with respect to research analyst account trading in securities of companies the research analyst covers. The current rules impose specific blackout periods during which a research analyst account may not trade covered securities and require pre-approval by legal and compliance of transactions in covered securities by persons who oversee research analysts. The current rules also provide several exceptions to the blackout periods, including where a report or change in rating or price target results from “significant news or a significant event concerning the subject company.” In addition, the blackout periods do not apply to: (1) transactions in the securities of a registered

⁴⁰ See proposed FINRA Rule 2241(b)(2)(N).

⁴¹ See proposed FINRA Rule 2241.05.

diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; or (2) purchases or sales of securities in other investment funds over which neither the research analyst nor a member of a research analyst's household has any investment discretion or control, provided that the research analyst account collectively owns interests representing no more than 1% of the fund's assets and that the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of businesses as companies in the research analyst's coverage universe. The rules further prohibit a research analyst account from purchasing or selling any security or any option or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member. Legal or compliance may authorize transactions otherwise prohibited by the rules based on an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that the authorization is in accordance with policies and procedures reasonably designed to avoid a conflict between the professional responsibilities of the research analyst and his or her personal trading and that the member maintains for three years written records documenting the justification for permitting the transaction.

The proposal instead requires that firms establish written policies and procedures that restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst.⁴² Such policies and procedures must ensure that research analyst accounts, supervisors of research analysts and associated persons

⁴² See proposed FINRA Rule 2241(b)(2)(J).

with the ability to influence the content of research reports do not benefit in their trading from knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report.⁴³ The proposal maintains, as minimum standards, the current prohibitions on research analysts receiving pre-IPO shares in the sector they cover and trading against their most recent recommendations. However, members may define financial hardship circumstances, if any, in which a research analyst would be permitted to trade against his or her most recent recommendation.⁴⁴ While the proposed rule change does not include a recordkeeping requirement, FINRA expects members to evidence compliance with their policies and procedures and retain any related documentation in accordance with FINRA Rule 4511. The proposed rule change includes Supplementary Material .10, which provides that FINRA would not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.⁴⁵ This provision is intended to provide a mechanism by which a firm's analysts can divest their holdings to comply with a more restrictive personal trading

⁴³ See proposed FINRA Rule 2241(b)(2)(J)(i).

⁴⁴ See proposed FINRA Rule 2241(b)(2)(J)(ii).

⁴⁵ See proposed FINRA Rule 2241.10.

policy without violating the trading against recommendation provision in circumstances where an analyst has, for example, a “buy” rating on a subject company.

FINRA believes these provisions will provide enhanced investor protection, while allowing firms to tailor management of conflicts related to personal trading of subject company securities to their particular size and business model. The enhanced protection results from expanding the scope of persons covered by the provisions to include not only research analyst accounts, but also those of supervisors and persons with an ability to influence the content of research reports. The proposal also preserves the key protections of the current rules by preventing research analysts from trading ahead of their customers and by generally requiring consistency between personal trading and recommendations to customers.

Content and Disclosure in Research Reports

With a couple of modifications, the proposed rule change maintains the current disclosure requirements. Thus, the proposed rule change maintains the mandated Sarbanes-Oxley disclosure requirements,⁴⁶ as well as additional disclosure obligations – meanings and distribution of ratings and price charts, for example – that are designed to provide investors with useful information on which to base their investment decisions. The proposed rule change also maintains the requirement that disclosures be presented on the front page of the research report or the front page must refer to the page on which the disclosures are found. Electronic research reports may provide a hyperlink directly to the

⁴⁶ See Section 501 Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

required disclosures. All disclosures and references to required disclosures must be clear, comprehensive and prominent.⁴⁷

The proposed rule change adds a requirement that a member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in its research reports are based on reliable information.⁴⁸ FINRA has included this provision because it believes members should have policies and procedures to foster verification of facts and trustworthy research on which investors may rely. The policies and procedures also must be reasonably designed to ensure that any recommendation or rating has a reasonable basis in fact and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation or rating.⁴⁹

In addition, the proposed rule change would require a member to disclose in any research report at the time of publication or distribution of the report:⁵⁰

- if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company

⁴⁷ See proposed FINRA Rule 2241(c)(6).

⁴⁸ See proposed FINRA Rule 2241(c)(1)(A).

⁴⁹ See proposed FINRA Rule 2241(c)(1)(B). This is substantively the same as NASD Rule 2711(h)(7) but in the form of policies and procedures.

⁵⁰ See proposed FINRA Rule 2241(c)(4). In comparing the proposed disclosure provisions to those in NASD Rule 2711, FINRA notes that in some instances the proposed rule change makes minor word or grammatical changes, uses streamlined language or has moved some text to Supplementary Material, but does not intend to change the substantive disclosure requirements. In those circumstances, FINRA considers the proposed disclosure provisions to be "substantively the same" as the current provisions.

(including, without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;⁵¹

- if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;⁵²
- if the member or any of its affiliates: (i) managed or co-managed a public offering of securities for the subject company in the past 12 months; (ii) received compensation for investment banking services from the subject company in the past 12 months; or (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;⁵³
- if, as of the end of the month immediately preceding the date of publication or distribution of a research report (or the end of the second most recent month if the publication or distribution date is less than 30 calendar days after the end of the most recent month), the member or its affiliates have received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;⁵⁴

⁵¹ See proposed FINRA Rule 2241(c)(4)(A). This is substantively the same as NASD Rule 2711(h)(1).

⁵² See proposed FINRA Rule 2241(c)(4)(B). This is substantively the same as NASD Rule 2711(h)(2)(A)(i)a.

⁵³ See proposed FINRA Rule 2241(c)(4)(C). This is substantively the same as NASD Rule 2711(h)(2)(A)(ii).

⁵⁴ See proposed FINRA Rule 2241(c)(4)(D). This provision, together with proposed FINRA Rule 2241.04, is substantively the same as NASD Rules 2711(h)(2)(A)(iii)a., (iv) and (v).

- if the subject company is, or over the 12-month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, must be identified as either investment banking services, non-investment banking services, non-investment banking securities-related services or non-securities services;⁵⁵
- if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report;⁵⁶ and
- if the research analyst received any compensation from the subject company in the previous 12 months.⁵⁷

The proposal also expands upon the current “catch all” disclosure, which mandates disclosure of any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know of at the time of the publication or distribution of a research report or public appearance.⁵⁸ The proposed rule change goes beyond the existing provision by requiring disclosure of material conflicts known not only by the research analyst, but also by any “associated person of the

⁵⁵ See proposed FINRA Rule 2241(c)(4)(E). This is substantively the same as NASD Rule 2711(h)(2)(A)(iii)b.

⁵⁶ See proposed FINRA Rule 2241(c)(4)(G). This is substantively the same as NASD Rule 2711(h)(8).

⁵⁷ See proposed FINRA Rule 2241(c)(4)(H). This is substantively the same as NASD Rule 2711(h)(2)(A)(i)b.

⁵⁸ For example, FINRA would consider it to be a material conflict of interest if the research analyst or a member of the research analyst’s household serves as an officer, director or advisory board member of the subject company.

member with the ability to influence the content of a research report.”⁵⁹ In so doing, the proposed rule change would capture material conflicts of interest that, for example, only a supervisor or the head of research may be aware of. The “reason to know” standard would not impose a duty of inquiry on the research analyst or others who can influence the content of a research report. Rather, it would cover disclosure of those conflicts that should reasonably be discovered by those persons in the ordinary course of discharging their functions.

The proposed rule change also modifies the requirement to disclose when a member or its affiliates own securities of the subject company to include any “significant financial interest in the debt or equity of the subject company,” including, at a minimum, beneficial ownership of 1% or more of any class of common equity securities of the subject company.⁶⁰ Thus, among other things, the proposal delineates the obligation to disclose significant debt holdings as a material conflict of interest that currently is captured by the “other material conflict of interest” provision referenced above. FINRA believes that an equity research report that analyzes the creditworthiness of the subject company could impact the price of the company’s debt securities, and therefore a material conflict exists where the member or its affiliates maintains significant debt holdings in the subject company. The determination of beneficial ownership would continue to be based upon the standards used to compute ownership for the purposes of the reporting requirements under Section 13(d) of the Exchange Act.

⁵⁹ See proposed FINRA Rule 2241(c)(4)(I).

⁶⁰ See proposed FINRA Rule 2241(c)(4)(F). The requirement to disclose beneficial ownership of 1% or more of any class of common equity securities of the subject company is the same as NASD Rule 2711(h)(1)(B).

The proposal retains the general exception for disclosure that would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.⁶¹ The proposal also continues to permit a member that distributes a research report covering six or more companies (compendium report) to direct the reader in a clear manner as to where the applicable disclosures can be found. An electronic compendium research report may hyperlink to the disclosures. A paper compendium report must include a toll-free number or a postal address where the reader may request the disclosures. In addition, paper research reports may include a web address where the disclosures can be found.⁶²

As detailed in the Joint Report, FINRA believes that a web-based disclosure approach would be at least as effective and a more efficient means to inform investors of conflicts of interests. To that end, FINRA recommended – and eventually proposed in SR-NASD-2006-113 – to permit members, in lieu of publication in the research report itself, to disclose their conflicts of interest by including a prominent warning on the cover of a research report that conflicts of interest exist, together with information on how the reader may obtain more detail about these conflicts on the member’s website. However, FINRA has subsequently been informed by SEC staff that it believes such a web-based disclosure approach would not be consistent with the Sarbanes-Oxley requirement “to

⁶¹ See proposed FINRA Rule 2241(c)(5).

⁶² See proposed FINRA Rule 2241(c)(7). This is substantively the same as Rule 2711(h)(11).

disclose [conflicts of interest] in each report”;⁶³ therefore, FINRA has not re-proposed it here.

Disclosures in Public Appearances

The proposal groups in a separate provision the disclosures required when a research analyst makes a public appearance.⁶⁴ The required disclosures remain substantively the same as under the current rules,⁶⁵ with one exception: consistent with the modification referenced above with respect to disclosure in research reports, a research analyst is similarly required to disclose in a public appearance if a member or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company, as computed in accordance with Section 13(d) of the Exchange Act. Unlike in research reports, the “catch all” disclosure requirement in public appearances applies only to a conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance and does not extend to conflicts that an associated person with the ability to influence the content of a research report or public appearance knows or has reason to know. The proposed rule change defines a person with the “ability to influence the content of a research report” as an associated person who, in the ordinary course of that person’s duties, has the authority to review the

⁶³ 15 U.S.C 78o-6(b).

⁶⁴ See proposed FINRA Rule 2241(d).

⁶⁵ See NASD Rules 2711(h)(1), (h)(2)(B) and (C), (h)(3) and (h)(9).

research report and change that research report prior to publication or distribution.⁶⁶

FINRA understands that supervisors typically do not have the opportunity to review and insist on changes to public appearances, many of which are extemporaneous in nature.

The proposal also retains the current requirement in NASD Rule 2711(h)(12) to maintain records of public appearances sufficient to demonstrate compliance by research analysts with the applicable disclosure requirements.⁶⁷

Disclosure Required by Other Provisions

With respect to both research reports and public appearances, members and research analysts would continue to be required to comply with applicable disclosure provisions of FINRA Rule 2210, Incorporated NYSE Rule 472 and the federal securities laws.⁶⁸

Termination of Coverage

The proposal retains with non-substantive modifications the provision in the current rules that requires a member to notify its customers if it intends to terminate coverage of a subject company.⁶⁹ Such notification must be made promptly⁷⁰ using the member's ordinary means to disseminate research reports on the subject company to its

⁶⁶ See proposed FINRA Rule 2241.08.

⁶⁷ See proposed FINRA Rule 2241(d)(3).

⁶⁸ See proposed FINRA Rule 2241(e). This is substantively the same as NASD Rule 2711(h)(9).

⁶⁹ See proposed FINRA Rule 2241(f).

⁷⁰ While current Rule 2711(f)(6) does not contain the word "promptly," FINRA has interpreted the provision to require prompt notification of termination of coverage of a subject company.

various customers. Unless impracticable, the notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a firm must disclose to its customers the reason for terminating coverage. FINRA expects such circumstances to be exceptional, such as where a research analyst covering a subject company or sector has left the member or the member has discontinued coverage of the industry or sector. FINRA believes this provision, which is consistent with the current rules, has been effective in achieving its original purpose to prevent firms from dropping coverage without notice or explanation instead of issuing a negative report on a current or prospective investment banking client.

Distribution of Member Research Reports

The proposal codifies an existing interpretation of FINRA Rule 2010 and provides additional guidance regarding selective – or tiered – dissemination of a firm’s research reports. In that regard, the proposal requires firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that the firm has previously determined are entitled to receive the research report.⁷¹ The proposal includes further guidance to explain that firms may provide different research products and services to different classes of customers, provided the products are not differentiated based on the

⁷¹ See proposed FINRA Rule 2241(g).

timing of receipt of potentially market moving information and the firm discloses its research dissemination practices to all customers that receive a research product.⁷²

A member, for example, may offer one research product for those with a long-term investment horizon (“investor research”) and a different research product for those customers with a short-term investment horizon (“trading research”). These products may lead to different recommendations or ratings, provided that each is consistent with the meaning of the member’s ratings system for each respective product. Thus, for example, a firm may define a “buy” rating in investor research to mean that a stock will outperform the S&P 500 over the next 12 months. The same firm may define “sell” in trading research to mean a stock will underperform its sector index over the next month. The firm could maintain a “buy” in investor research at the same time it had a “sell” in trading research on the same stock if the firm believed, for example, that the company would report an earnings shortfall next week that would lead to a short-term drop in price relative to the sector index, but that the stock would recover to outperform the S&P 500 over the next 12 months. However, a member may not differentiate a research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member label a research product with substantially the same content as a different research product as a means to allow certain customers to trade in advance of other customers.

In addition, a member that provides different research products and services for certain customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the

⁷² See proposed FINRA Rule 2241.07.

price of the security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research. FINRA understands, however, that customers may actually receive at different times research reports originally made available at the same time because of the mode of delivery elected by the customer eligible to receive such research services (e.g., in paper form versus electronic). However, members may not design or implement a distribution system intended to give a timing advantage to some customers over others. FINRA will read with interest comments as to whether a member should be required to disclose to its other customers when an alternative research product or service does, in fact, contain a recommendation contrary to the research product or service that those customers receive.

Distribution of Third-Party Research Reports

The proposal expands upon the third-party research report distribution requirements in the current rules. The proposal generally maintains the existing third-party disclosure requirements,⁷³ with one modification. Consistent with the proposed disclosure requirement discussed above with respect to a member's own research reports,

⁷³ NASD Rule 2711(h)(13)(A) currently requires the distributing member firm to disclose the following, if applicable: (1) if the member owns 1% or more of any class of equity securities of the subject company; (2) if the member or any affiliate has managed or co-managed a public offering of securities of the subject company or received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for such services in the next three months; (3) if the member makes a market in the subject company's securities; and (4) any other actual, material conflict of interest of the research analyst or member of which the research analyst knows or has reason to know at the time the research report is distributed or made available.

a distributing member would be required to disclose if the member or its affiliates maintain a significant financial interest in the debt or equity securities of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The proposed rule change also would require members to disclose any other material conflict of interest that can reasonably be expected to have influenced the member's choice of a third-party research provider or the subject company of a third-party research report.⁷⁴ FINRA believes that it is important that readers be made aware of any conflicts of interest present that may have influenced either the selection or content of research disseminated to investors. As is the case in the existing Rules, the proposal requires that a member establish, maintain and enforce written policies and procedures reasonably designed to ensure the completeness and accuracy of all of the applicable disclosures to any third-party research it distributes.

In addition, the proposal continues to address qualitative aspects of third-party research reports. For example, the proposal maintains, but in the form of policies and procedures, the existing requirement that a registered principal or supervisory analyst review and approve third-party research reports distributed by a member. To that end, the proposed rule change requires a member to establish, maintain and enforce written policies and procedures reasonably designed to ensure that any third-party research it contains no untrue statement of material fact and is otherwise not false or misleading. For the purpose of this requirement, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading

⁷⁴ See proposed FINRA Rule 2241(h)(4).

information that should be known from reading the research report or is known based on information otherwise possessed by the member.⁷⁵ The proposal further prohibits a member from distributing third-party research if it knows or has reason to know that such research is not objective or reliable.⁷⁶ FINRA believes that, where a member is distributing or “pushing-out” third-party research, the member must have policies and procedures to vet the quality of the research producers. A member would satisfy the standard based on its actual knowledge and reasonable diligence; however, there would be no duty of inquiry to definitively establish that the third-party research is, in fact, objective and reliable.

The proposal maintains the existing exceptions for “independent third-party research reports.” Specifically, such research does not require principal pre-approval or, where the third-party research is not “pushed out,” the third-party disclosures.⁷⁷ As to the latter, a member will not be considered to have distributed independent third-party research where the research is made available by the member: (a) upon request; (b) through a member-maintained website; or (c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

Finally, under the proposal, members also must ensure that a third-party research report is clearly labeled as such and that there is no confusion on the part of the recipient

⁷⁵ See proposed FINRA Rules 2241(h)(1) and (h)(3).

⁷⁶ See proposed FINRA Rule 2241(h)(2).

⁷⁷ See proposed FINRA Rule 2241(h)(5) and (6).

as to the person or entity that prepared the research report.⁷⁸ This requirement codifies guidance provided in Notice to Members 04-18.

Exemption for Firms with Limited Investment Banking Activity

The current rule exempts firms with limited investment banking activity – those that over the previous three years, on average per year, have managed or co-managed 10 or fewer investment banking transactions and generated \$5 million or less in gross revenues from those transactions – from the provisions that prohibit a research analyst from being subject to the supervision or control of an investment banking department employee because the potential conflicts with investment banking are minimal.⁷⁹ However, those firms remain subject to the provision that requires the compensation of a research analyst to be reviewed and approved annually by a committee that reports to a member’s board of directors, or a senior executive officer if the member has no board of directors.⁸⁰ That provision further prohibits representation on the committee by investment banking department personnel and requires the committee to consider the following factors when reviewing a research analyst’s compensation: (1) the research analyst’s individual performance, including the research analyst’s productivity and the quality of research; (2) the correlation between the research analyst’s recommendations and the performance of the recommended securities; and (3) the overall ratings received from clients, the sales force and peers independent of investment banking, and other

⁷⁸ See proposed FINRA Rule 2241(h)(7).

⁷⁹ See NASD Rule 2711(k).

⁸⁰ See NASD Rule 2711(d)(2).

independent ratings services.⁸¹ Thus, the current exemption provides limited relief with respect to research analyst compensation determination, even where it is permissible for an investment banker to supervise and control a research analyst. FINRA believes it follows logically to allow those who supervise research analysts under such circumstances also to be involved in all aspects of the evaluation and determination of those analysts' compensation. Therefore, the proposed rule change extends the exemption for firms with limited investment banking activity so that such firms would not be subject to the compensation committee provision. FINRA notes that the proposal still prohibits these firms from compensating a research analyst based upon specific investment banking services transactions or contributions to a member's investment banking services activities.⁸²

The proposed rule change further exempts firms with limited investment banking activity from the provisions restricting or limiting research coverage decisions and budget determination. While these two provisions are not in the current rules, as noted above, FINRA interprets NASD Rule 2711(b) to prohibit investment banking from making any final coverage decisions or determination of research budget. As such, the current exemption in NASD Rule 2711(k) effectively covers these two new provisions and so the proposal does not represent a substantive change. In addition, the proposal exempts eligible firms from the requirement to establish information barriers or other institutional safeguards to insulate research analysts from the review or oversight by investment banking personnel or other persons, including sales and trading personnel, who may be

⁸¹ See NASD Rule 2711(d) and (k).

⁸² See proposed FINRA Rules 2241(b)(2)(E) and (i).

biased in their judgment or supervision. However, those firms still are required to establish, maintain and enforce written policies and procedures reasonably designed to ensure that research analysts are insulated from pressure by investment banking and other non-research personnel who might be biased in their judgment or supervision. FINRA believes that even where research analysts need not be structurally separated from investment banking or other non-research personnel, they should not be subject to pressures that could compromise their independence and objectivity.

FINRA reviewed and analyzed deal data for calendar years 2009 through 2011 to determine whether any adjustments should be made to these exemption standards. The review targeted firms that either managed or co-managed deals and earned underwriting revenues from those transactions during the review period. The analysis found that 155 of 317 such firms – or 49% – would have been eligible for the exemption. The data further suggested that incremental upward adjustments to the exemption thresholds would not result in a significant number of additional firms eligible for the exemption. For example, increasing both of the thresholds by 33% (to 40 transactions managed or co-managed and \$20 million in gross revenues over a three-year period) would result in 18 additional exempted firms. As such, FINRA believes the current exemption produces a reasonable and appropriate universe of exempted firms.

Exemption from Registration Requirements for Certain “Research Analysts”

As recommended in the Joint Report, the proposed rule change amends the definition of “research analyst” for the purposes of the registration and qualification requirements to limit the scope to persons who produce “research reports” and whose primary job function is to provide investment research (e.g. registered representatives or

traders generally would not be included).⁸³ The revised definition is not intended to carve out anyone for whom the preparation of research is a significant component of their job; rather, it is intended to provide relief for those who produce research reports on an occasional basis. The existing research rules, in accordance with the Sarbanes-Oxley mandates, are constructed such that the author of a communication that meets the definition of a “research report” is a “research analyst,” irrespective of his or her title or primary job. FINRA believes that the registration and qualification requirements, which are not mandated by Sarbanes-Oxley, were intended for those individuals whose principal job function is to produce research, while the balance of the research rules are intended to foster objective analysis, transparency of certain conflicts and to provide beneficial information to investors. As such, the proposed exemption would extend only to the registration requirements, while all other obligations applicable to the production and distribution of research reports would remain.

Attestation Requirement

The proposal deletes the requirement to attest annually that the firm has in place written supervisory policies and procedures reasonably designed to achieve compliance with the applicable provisions of the rules, including the compensation committee review provision. FINRA notes that firms already are obligated pursuant to NASD Rule 3010 (Supervision) to have a supervisory system reasonably designed to achieve compliance with all applicable securities laws and regulations and FINRA rules. Moreover, the research rules also are subject to the supervisory control rules (NASD Rule 3012) and the

⁸³ See proposed NASD Rule 1050(b) and proposed Incorporated NYSE Rule 344.10.

annual certification requirement regarding compliance and supervisory processes (FINRA Rule 3130).⁸⁴ As such, FINRA believes a separate attestation requirement for the research rules is unnecessary.

Obligations of Persons Associated with a Member

Supplementary Material .09 clarifies the obligations of each associated person under those provisions of the proposed rule change that require a member to restrict or prohibit certain conduct by establishing, maintaining and enforcing particular written policies and procedures. Specifically, the rule provides that, consistent with FINRA Rule 0140, persons associated with a member must comply with such member's policies and procedures as established pursuant to proposed FINRA Rule 2241.⁸⁵ Failure of an associated person to comply with such policies and procedures shall constitute a violation of the rule itself. In addition, consistent with Rule 0140, the rule states that it shall be a rule violation for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by provisions of Rule 2241, including applicable Supplementary Material, that embed in the policies and procedures specific obligations on individuals. This Supplementary Material reflects FINRA's position that associated persons can be held liable for engaging in conduct that is proscribed by the member under FINRA rules. FINRA is clarifying this point in the Supplementary Material because the proposed rule

⁸⁴ NASD Rules 3010 and 3012 have been adopted with changes as consolidated FINRA rules. The new rules become effective December 1, 2014. See supra note 19.

⁸⁵ See proposed FINRA Rule 2241.09. FINRA Rule 0140(a), among other things, provides that persons associated with a member shall have the same duties and obligations as a member under the Rules.

change would adopt a policies and procedures approach to restricted and prohibited conduct with respect to research in place of specific proscriptions in the current rules.

Thus, for example, where the proposed rule requires a member to establish policies and procedures to prohibit research analyst participation in road shows, associated persons also are directly prohibited from engaging in such conduct, even where a member has failed to establish policies and procedures. FINRA believes that it is incumbent upon each associated person to familiarize themselves with the regulatory requirements applicable to his or her business and should not be able to avoid responsibility where minimum standards of conduct have been established for members.

General Exemptive Authority

The proposed rule change would provide FINRA, pursuant to the Rule 9600 Series, with authority to conditionally or unconditionally grant, in exceptional and unusual circumstances, an exemption from any requirement of the proposed rule for good cause shown, after taking into account all relevant factors and provided that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.⁸⁶ Given the scope of the rule's subject matter and the diversity of firm sizes, structures and research business and distribution models, FINRA believes it would be useful and appropriate to have the ability to provide relief from a particular provision of the proposed rules under specific factual circumstances.

As noted in Item 2 of this filing, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days

⁸⁶ See proposed FINRA Rule 2241(j).

following Commission approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸⁷ which requires, among other things, that FINRA 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. FINRA believes the proposed rule change protects investors and the public interest by maintaining, and in some cases expanding, structural safeguards to insulate research analysts from influences and pressures that could compromise the objectivity of research reports and public appearances on which investors rely to make investment decisions. FINRA further believes that the proposed rule change prevents fraudulent and manipulative acts and practices by requiring firms to identify and manage, often with extensive disclosure, conflicts of interest related to the preparation, content and distribution of research. At the same time, the proposal furthers the public interest by increasing information flow to investors in select circumstances – e.g., before and after the expiration of lock up provisions – where FINRA believes the integrity of research will not be compromised.

Moreover, the proposed rule change is consistent with Section 15D of the Act,⁸⁸ which requires rules reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public

⁸⁷ 15 U.S.C. 78o-3(b)(6).

⁸⁸ 15 U.S.C. 78o-6.

appearances. The proposed rule change requires firms to establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with the provisions of Section 15D, including: restricting prepublication clearance or approval of research reports by investment banking personnel or other persons not directly responsible for the preparation, content and distribution of research reports; prohibiting persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination; prohibiting retaliation or threat of retaliation against research analysts for research or public appearances that are unfavorable to the member's business interests; establishing quiet periods after public offerings during which members that have participated in the offering may not publish or otherwise distribute research; and establishing structural or institutional safeguards to protect analysts from the review, pressure or oversight of investment bankers or other non-research personnel that might be biased in their judgment or supervision. In addition, the proposed rule change requires disclosures consistent with Section 15D, including the requirement to disclose any material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of publication or distribution of a research report or during a public appearance.

4. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change primarily reorganizes and restructures the current research rules, while maintaining the core provisions that have generally proven effective

to promote objective and reliable research, as detailed through academic studies and other observations in the Joint Report and the GAO Report.⁸⁹ The GAO Report, for example, concluded that empirical results suggest the rules have resulted in increased analyst independence and weakened the influence of conflicts of interest on analyst recommendations.⁹⁰ The proposed rule change also amends the current rules to ensure the objectives of independent research analysts and unbiased research are achieved in the most effective manner.

In some places, the proposed rule change reduces regulatory uncertainty around the applicability of current rules. For example, the new provision regarding distribution of member research clarifies an existing interpretation prohibiting selective dissemination of research and provides guidance as to how members may differentiate research products to customers. In other places, the proposed rule change extends existing protections and adds new protections to fill gaps in the rules. Thus, the proposed rule change requires members to proactively identify and mitigate emerging conflicts related to the production and distribution of research, as members are best situated to spot such conflicts that may arise based on their particular business models or structures. As another example, the proposed rule change also extends the obligation to disclose material conflicts to associated persons with the ability to influence the content of a research report. This provision would close a gap that exists whereby persons who oversee research and research analysts could influence the recommendation or conclusions in a research report without disclosing their own material conflicts of interest

⁸⁹ See Joint Report, supra note 5 at 16-26; see GAO Report, supra note 6 at 12-23.

⁹⁰ See GAO Report, supra note 6 at 12-15.

or those of the member of which only they, and not the research analyst, know or have reason to know.

The new rules would impose burdens primarily arising from establishing, maintaining and enforcing new written policies and procedures to comply with the rule change, as well as a few new disclosures to customers to the extent a member's research activities require them. FINRA believes the additional burdens associated with these new provisions are minimal, but necessary to ensure the protections of the rules cannot be frustrated. At the same time, the proposed rule change provides increased flexibility for members to create compliance programs more closely tailored to their businesses and organizational structures, without diminishing investor protection. For example, as detailed in Item 3 of this filing, the proposed rule change replaces the many current prescriptive requirements with respect to personal trading by research analyst accounts with a more flexible approach that requires policies and procedures to ensure that such accounts do not benefit in their trading from knowledge of the content and timing of research before the intended recipients have a reasonable opportunity to act on the information. FINRA believes this proposed change will maintain the current protection against a research analyst putting his or her own financial interests ahead of the analyst's customers' interest, but the increased flexibility will reduce costs and create fewer impediments to competition.

The proposed rule change also promotes capital formation and lessens compliance costs for firms by eliminating or reducing quiet periods during which research cannot be published or otherwise disseminated. FINRA further analyzed deal data to confirm that the parameters for the exemption for firms with limited investment banking activity

remain appropriate and extended the exemption to include compensation determination provisions, thereby relieving eligible firms from an appreciable burden. The proposed rule change also lessens costs by creating a new limited exemption from the registration requirements for “research reports” produced by persons whose primary job function is something other than producing research and by eliminating the annual attestation requirement.

To help assess and minimize any burden on competition resulting from the proposal, FINRA consulted with several of its advisory committees and other industry members to solicit suggested changes to the existing rules and to obtain feedback on FINRA’s proposed changes. Finally, as set forth in Item 5 of this filing, FINRA carefully considered comments to an earlier version of the proposed rule change and made several changes in response to those comments.

5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA solicited comments on an earlier iteration of the proposed rule change in Regulatory Notice 08-55 (“Notice Proposal”). The comment deadline expired on November 14, 2008. FINRA received five responses to the Notice Proposal.⁹¹

Commenters expressed support for many aspects of the proposal, including reductions to

⁹¹ Letter from Daniel H. Kolber, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 10, 2008 (“Kolber”); letter from John I. Fitzgerald, Leerink Swann LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 10, 2008 (“Leerink”); letter from Goodwin Procter LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 11, 2008 (“NVCA”); letter from Elliot R. Curzon, Dechert LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 (“Dechert”); and letter from Amal Aly, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 (“SIFMA”).

the quiet period provisions, the exemption for members with limited investment banking activity and the more flexible supervisory approach with respect to research analyst account trading. SIFMA further expressed appreciation for the guidance with respect to selective dissemination of research products. Commenters nevertheless urged several modifications to the proposal, some of which have been incorporated into the proposed rule change. FINRA responds to the material comments to the Notice Proposal below.

Policies and Procedures

Both the Notice Proposal and the proposed rule change differ in several respects from current NASD Rule 2711, perhaps most notably in adopting a policies and procedures approach to identification and management of equity research-related conflicts. FINRA has reintroduced several current provisions to the proposed rule change to clarify certain minimum standards and disclosure requirements. However, FINRA notes that the proposed rule change also establishes new standards of conduct. FINRA will provide guidance, where appropriate, as to the application of the new standards. FINRA cautions that members should not conclude that, where specific conduct prohibitions or disclosure requirements that exist in the current provisions have not been expressly included in the proposed rule change, such conduct is now permissible or such disclosures are no longer required. Firms must apply the new proposed standards to make those determinations. FINRA notes that some of the new standards are intended to require thoughtful compliance by members that may require them to adapt and change their policies and procedures as they gain experience and encounter new circumstances that may impact on the objectivity and reliability of research.

SIFMA endorsed the principle in the Notice Proposal and proposed rule change that members must implement policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts. Yet SIFMA found ambiguous and overbroad the companion principle that such policies and procedures should promote “reliable” research that reflects the “truly held opinions” of research analysts and prevent the use of research to “manipulate or condition the market” or “favor the interests of the member or certain current or prospective clients.” SIFMA asked FINRA to delete this introductory sentence and substitute the following alternative: “a member’s policies and procedures must be reasonably designed to promote independent and objective research that reflects the personal views of the analyst.” Among other things, SIFMA asserted that the concept of “reliable” research is new and undefined.

FINRA believes that the term “reliable” is commonly understood. FINRA further believes that the other terms referenced above and cited by SIFMA as vague are similarly unambiguous in describing the conduct that a member’s policies and procedures must address or guard against. SIFMA made similar comments with respect to the words “reliable information” in the content and disclosure requirements of the Notice Proposal. As discussed below in response to that comment, that term is used in Sarbanes-Oxley without definition.

SIFMA requested that FINRA confirm that with respect to the proposed prohibitions on analyst compensation, consistent with current rules, the proposal would not prevent a member from compensating analysts for engaging in permissible vetting,

commitment committee participation, due diligence, teach-ins, investor education, and other permissible banking-related activities. SIFMA also recommended that the proposal be amended so that compensation committees are required to consider the enumerated factors when reviewing a research analyst's compensation only to the extent they are applicable. SIFMA suggested adding two new factors that are permissible for members to consider in determining analyst compensation, including the analyst's seniority and experience, and the market for hiring and retention of analysts, noting that these factors are critical to the proper determination of analyst compensation and are specifically identified in the Global Settlement.

The proposal prohibits compensation based upon specific investment banking transactions or contributions to a member's investment banking services activities. It also requires the compensation review committee to consider the research analyst's productivity and quality of research. Both of these standards exist in the current rules. As SIFMA noted, FINRA staff previously stated that "screening potential investment banking clients is one of many factors to measure the quality of an analyst's research."⁹² As such, FINRA concluded that the activity could be considered in determining a research analyst's compensation but "may not be given undue weight relative to evaluating the quality of other research work product." FINRA further cautioned, however, that "the size of any resultant or excluded investment banking deals should be irrelevant in assessing the quality of research."⁹³ The same guidance applies to the

⁹² See Letter from Philip A. Shaikun, Associate General Counsel, NASD, to James A. Brigagliano, Assistant Director, Division of Market Regulation, SEC, dated July 29, 2003, at page 8.

⁹³ Id.

compensation provisions in the proposed rule change. FINRA considers commitment committee participation to be part of the vetting process and further views permissible due diligence and education of the sales force and investors as other legitimate factors to consider in measuring the productivity and quality of research, with the same caveats previously articulated regarding undue weight and the size of related investment banking services transactions. FINRA has amended the proposed rule text to clarify that the enumerated factors must be considered only to the extent applicable. The proposed rule change does not preclude consideration of additional factors, including the analyst's experience and market factors. The proposed rule change only sets out requirements and prohibitions with respect to compensation, and therefore FINRA has not included in the rule text the suggested permissible factors.

SIFMA stated its support for "the general principle that members should implement policies and procedures reasonably designed to prevent market manipulation or front running of research." However, SIFMA questioned the necessity of FINRA's language in proposed Rule 2241(b)(2) that would require a firm's policies and procedures to be reasonably designed to prevent the use of research reports or research analysts to "manipulate or condition the market or favor the interests of the member or certain current or prospective clients." According to SIFMA, that principle is already codified in existing SEC anti-manipulation rules and FINRA's front running prohibition in FINRA Rule 5270. Even if true, FINRA believes it is entirely appropriate to include that important principle as it relates to research reports and research analysts in a rule that is dedicated to research conflicts of interest and the conduct of research analysts.

Moreover, FINRA notes that the proscribed conduct in its proposal is not congruent with either the SEC anti-manipulation or FINRA front running rules.

The Notice Proposal required members to “establish information barriers and other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight of persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision.”

SIFMA suggested that members should be able to establish information barriers or other institutional safeguards to foster the required research analyst objectivity, since some information barriers are not always the most appropriate or efficient means to manage research conflicts. FINRA agrees and has amended the proposed rule change accordingly.

SIFMA further urged FINRA to replace the phrase “persons who might be biased in their judgment or supervision” with “persons within the firm who may try to improperly influence analysts’ views” because SIFMA contended that the former might sweep in salespeople, traders or subject companies that could have biases. FINRA notes that the proposed rule text came directly from the provisions of Sarbanes-Oxley related to management of research conflicts. FINRA believes that language is intended to apply only to persons within the firm and does not extend to subject companies, which have no oversight or supervisory role with respect to research analysts within a broker-dealer. Moreover, FINRA believes it’s appropriate for this conflict management provision to include salespeople or traders to the extent that a member employs such individuals in an oversight or supervisory capacity and has reason to know that some or all of those

individuals might be biased in discharging those obligations. As such, FINRA has maintained the provision in the proposed rule change.

The Notice Proposal required members to prevent direct or indirect retaliation or threat of retaliation against research analysts by persons engaged in investment banking or other employees as the result of content of a research report. The proposed rule change maintains this requirement, but substitutes “prohibit” for “prevent” to align with the current rule language. SIFMA stated that the proposed provision is too broad because it applies to all employees, not just those involved in the investment banking department, and recommended that FINRA retain the current anti-retaliation provision in NASD Rule 2711(j). FINRA disagrees. As stated in the Joint Report, FINRA believes that under no circumstances is retaliation appropriate against a research analyst who expresses his or her truly held beliefs about a subject company. To the extent a person outside the investment banking department is in a position to retaliate or threaten to retaliate against a research analyst – e.g., if the person is the chief executive officer, supervises the research analyst or is a member of the compensation review committee – FINRA believes the ban should cover them.

The Notice Proposal provided a more flexible supervisory approach with respect to trading by analyst accounts in securities of companies covered by the research analyst. SIFMA supported the proposed approach but asked FINRA to confirm that if members have adopted internal policies prohibiting analysts from owning securities issued by companies the analyst covers, members may permit an analyst to divest any such holdings pursuant to a reasonable plan of liquidation within 120 days of the effective date

of the member's policy even if the sale is inconsistent with the analyst's current recommendation.

In response, FINRA has included in the proposed rule change Supplementary Material .10, which states that FINRA shall not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles that prohibit an analyst from benefitting from his or her personal trading based on the knowledge of the timing or content of a research report and that such plan is approved by the member's legal or compliance department.

The Notice Proposal required members to establish, maintain and enforce policies and procedures that prohibit participation by research analysts in "road shows and other marketing on behalf of issuers." SIFMA asked FINRA to clarify that the proscription does not apply to "investor education activities" and further is limited only to activities in connection with investment banking services transactions. By way of example, SIFMA suggested that the proposal would prohibit the practice by research analysts to facilitate meetings between investors and company management – so-called "non-deal road shows." Leerink also questioned the scope of the provision and requested clarification with respect to whether the proposed language intends to eliminate the condition in Rule 2711 that the prohibition relate to the analyst's participation in the marketing of a specific investment banking services transaction and, instead, would prohibit all participation in marketing by research analysts whether or not related to investment banking services.

Leerink noted that not every contact with a company should be viewed as marketing the investment banking services of the analyst's firm or jeopardizing the analyst's objectivity. Leerink further noted that it would deprive analysts of important information necessary for their role if they are prohibited from contacts with an issuer in circumstances where the issuer may be marketing itself, including attendance by a research analyst at a research conference or investor forum. SIFMA also requested that FINRA confirm that consistent with existing guidance (NASD Notice to Members 07-04 and NYSE Information Memo 07-11) analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.

FINRA agrees that research analysts should be able to educate investors, provided such education occurs outside the presence of investment bankers and issuer management and any such presentations are done in a fair and balanced manner. The proposed rule change therefore contains Supplementary Material .03 setting forth such permissible conduct, thus maintaining the current standard.

As discussed in the Purpose section, FINRA believes the primary role of research analysts is to function as unbiased intermediaries between issuers and the investors who buy the issuers' securities. FINRA believes marketing by research analysts on behalf of issuers is antithetical to promoting objective research on such issuers' securities. FINRA is primarily concerned with marketing by research analysts in connection with an investment banking services transaction, and therefore FINRA has added that clarification to the provision in the proposed rule change.

FINRA notes, however, that the overarching requirement to have policies and procedures to manage conflicts related to the interaction between research analysts and, among others, subject companies would apply to other marketing activity on behalf of an issuer. FINRA does not believe that merely facilitating a meeting between issuer management and investors, absent other facts, would constitute marketing on behalf of the issuer. Similarly, to Leerink's question, FINRA does not believe that mere attendance by a research analyst at a conference or forum where an issuer makes a presentation about its business prospects constitutes marketing "on behalf of an issuer." Nor would FINRA consider it marketing on behalf of an issuer for a member to sponsor such a conference or forum and permit its research analysts to attend or facilitate discussion. FINRA believes that there is a fundamental distinction between an issuer that markets itself and a research analyst who markets on behalf of the issuer. It is the latter conduct that FINRA believes creates a conflict for a research analyst that must be prohibited or otherwise managed.

As noted in the Purpose section, the existing guidance in Notice to Members 07-04 would continue to apply to research analyst participation in road shows. Therefore, a research analyst would be able to listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.

Distribution of Member Research Reports

Leerink sought clarification regarding the scope of proposed Rule 2241(g) in the Notice Proposal, a codification of an interpretation to then NASD Rule 2110⁹⁴ that prohibits selective dissemination of a research report to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the report. Leerink questioned whether the proposed Supplementary Material regarding that provision would extend the prohibition beyond research reports to other services because it refers to “research products and services” and is not limited to “research reports.” Leerink requested clarification as to how FINRA would define “research products and services” and whether it would prohibit more generally favoring one type of client over another. The proposed Supplementary Material requires a member that provides different research products and services to different customers to notify the other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security. Leerink also asked whether there should be a carve out from the notification provision for institutional clients, and, if not, whether an oral notification would be sufficient, given the nature of firms’ relationships with institutional clients.

FINRA first notes that Leerink mistakenly believed that FINRA was proposing to modify its prohibition regarding trading ahead of research reports found in then NASD IM-2110-4. In fact, that Interpretive Material referred to similar but distinct conduct

⁹⁴ FINRA has since adopted NASD Rule 2110 as FINRA Rule 2010 without change. See Securities Exchange Act Release No. 58643 (September 25, 2008), 73 FR 57174 (October 1, 2008) (Order Approving File No. SR-FINRA-2008-028).

regarding adjusting a member's inventory based upon non-public information regarding the timing or content of an impending research report. The Commission has since approved FINRA Rule 5280, which transferred NASD IM-2110-4 into the Consolidated FINRA Rulebook with changes.⁹⁵ The proposed rule change incorporates the aspect in FINRA Rule 5280 that the content of a research report may not be provided to internal trading personnel prior to public dissemination, but goes beyond that more narrow focus to address dissemination of a research report to one or more customers prior to other customers that the firm has previously determined are entitled to that report. The provision and accompanying Supplementary Material in the proposed rule change are limited by their terms to the dissemination of research products and services and do not address the broader question of when a member may not favor one client over another. FINRA included research "products and services" because FINRA understands that some customers receive not only different types of research reports than other customers, but also might receive other additional services related to research, such as more opportunity to interact directly with a research analyst. The Supplementary Material explains that offering those different services are permissible, provided they do not include differential timing in the receipt of potentially market moving information, including oral dissemination.

FINRA believes that the notification requirement in the Supplementary Material should apply to all customers that receive a research product or service from the member if the member provides different research products to different customers. FINRA notes

⁹⁵ See Securities Exchange Act Release No. 59254 (January 15, 2009), 74 FR 4271 (January 23, 2009) (Order Approving File No. SR-FINRA-2008-054).

that, consistent with Sarbanes-Oxley, the other provisions of the current and proposed rules do not differentiate between retail and institutional customers and further notes that not all institutional customers have the sophistication and experience to know without disclosure the nature and impact of differing research products and services. However, FINRA believes firms may put in place any reasonably designed notification process, provided they can evidence compliance with the requirement.

Quiet Periods

SIFMA, Leerink and NVCA generally supported the provisions in the Notice Proposal that would reduce the quiet period after IPOs for managers and co-managers from 40 days to 10 days, eliminate the quiet period after secondary offerings and eliminate the quiet periods around the waiver, expiration or termination of a lock-up agreement. These commenters believed that the Notice Proposal struck an appropriate balance between addressing conflicts and facilitating the flow of important information to investors. NVCA agreed with FINRA that other provisions of the Notice Proposal, together with SEC Regulation AC, would sufficiently maintain the integrity of research issued during what are now quiet periods.⁹⁶ The proposed rule change maintains these provisions, except that it imposes a minimum three-day quiet period after a secondary offering, unless an exception applies. FINRA made this change because SEC staff determined that Sarbanes-Oxley mandates a minimum quiet period for underwriters after a secondary offering. FINRA believes the proposed three-day period will fairly effectuate that mandate while minimizing the effect on information flow.

⁹⁶ The remainder of the NVCA letter addressed more general matters concerning the strength and competitiveness of the U.S. IPO market that were not specifically directed at the FINRA proposal.

Content and Disclosure in Research Reports

With a couple of modifications, the Notice Proposal and the proposed rule change maintain the current content and disclosure requirements. The proposed rule change adds a requirement that a member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in its research reports are based on reliable information. The proposed rule change maintains the mandated Sarbanes-Oxley disclosure requirements,⁹⁷ as well as additional disclosure obligations – meanings and distribution of ratings and price charts, for example – that are designed to provide investors with useful information on which to base their investment decisions.

SIFMA was concerned by the use of the term “reliable” in the proposed provision that would require members to ensure that purported facts in their research reports are based on reliable information. As stated above, FINRA believes that term “reliable” is commonly understood. We note, for example, that the term “reliable information” is used in the research provisions of Sarbanes-Oxley without definition. Furthermore, SIFMA recommended the following as an alternative to the provision that members ensure that purported facts in research reports be based on reliable information: “policies and procedures reasonably designed to ensure that facts are based on ‘sources believed by the member firm to be reliable.’” (emphasis added). SIFMA appears to have borrowed the latter phrase from Exchange Act Rule 15c2-11(a), which also uses the term “reliable” without definition.

The Notice Proposal required a member to ensure that any recommendation, rating or price target have a “reasonable basis in fact” and be accompanied by a “clear

⁹⁷ See Section 501 Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

explanation of the valuation method utilized and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.” SIFMA recommended two changes to this provision. First, SIFMA suggested that FINRA substitute the term “reasonable basis” rather than “reasonable basis in fact.” FINRA believes that even judgments and estimates on which recommendations, ratings and price targets are based must be grounded in certain facts, but we also believe that the term “reasonable basis” implies as much. Therefore, the proposed rule change maintains the “reasonable basis” standard in the current rule. SIFMA also noted that not all ratings are based on a valuation method, so FINRA has modified the language in the proposed rule change to that effect.

SIFMA also objected to the requirement in the proposal that a member must disclose in any research report “all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report.” SIFMA contended that the language would require members to identify “all possible conflicts (material or immaterial) that may be known to anyone at the member.” SIFMA recommended that FINRA revise the language to require only the enumerated disclosures, including the “catch-all” disclosure of “any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of the research report.” In addition, SIFMA urged FINRA to revise this provision so that it is consistent with current requirements because the mandate that the disclosures be made with respect to material

conflicts of interest that are known not only at the time of publication, but also at the time of the distribution of a research report, is unworkable.

In general, FINRA believes that an immaterial conflict could not reasonably be expected to influence the objectivity of a research report, and therefore a materiality standard is essentially congruent with the proposed standard. FINRA agrees that the “catch-all” disclosure provision captures such material conflicts that the research analyst and persons with the ability to influence the content of a research report know or have reason to know. Therefore, FINRA has amended the proposal to delete as superfluous the overarching obligation to disclose “all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report.” FINRA notes that the term “distribution” is drawn from the provisions of Sarbanes-Oxley that apply to equity research reports and is intended to capture research that may only be distributed electronically as opposed to published in hard copy. However, FINRA interprets this language to require the disclosures to be current only as of the date of first publication or distribution, provided that the research report is prominently dated, and the disclosures are not known to be misleading.

SIFMA also labeled as unnecessary and burdensome the proposal’s requirement to disclose if the member or its affiliates maintain a significant financial interest in the debt of a subject company. It asserted that such disclosure has little utility for investors, yet would require considerable resources to track such information. SIFMA also noted that to the extent that a member’s ownership interest in a debt security presents a material conflict of interest, disclosure is already required by the “catch-all” provision that

requires a member to disclose “any other material conflict of interest of the research analyst or member that the research analyst or a person associated with a member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.”

FINRA believes that a significant debt holding in the subject company could very well present a material conflict of interest that could inform an investor’s decision making. For example, a negative equity research report that discusses a subject company’s ability to meet its debt service or certain bond covenants could impact the value of high yield or other debt held by the member. FINRA also notes that the proposed disclosure is similar to that required by the United Kingdom’s Financial Conduct Authority, whose rules many of SIFMA’s members with global operations are already subject to. And while it is true that material conflicts can be captured by the “catch-all” provision, that should not preclude FINRA from delineating specific disclosures as it has with several other disclosures, including investment banking relationships.

SIFMA stated that it continues to believe that web-based disclosure promotes efficiency, provides important information to investors in a meaningful and effective manner, and is consistent with important initiatives by the SEC to promote the use of electronic media, particularly with respect to price charts and ratings distribution tables, which are often cumbersome and difficult to produce in individual research reports. SIFMA contended that web-based disclosure would greatly ease production burdens and streamline the research reports themselves if they could be provided through websites. SIFMA also urged FINRA to consider permitting a web-based disclosure regime for

public appearances because it would allow investors to consider and appreciate more fully the disclosures related to these activities. SIFMA states that web-based disclosures would allow investors to download, review, and assess the disclosures (as opposed to simply hearing them recited before or after an appearance, at which time investors may not focus on the substance of the disclosures). As stated in the Purpose section, FINRA was informed by SEC staff that it believes a web-based disclosure approach would not be consistent with Sarbanes-Oxley; therefore, FINRA has not proposed it here.

Third-Party Research

SIFMA noted that the Notice Proposal would impose a new requirement that members adopt policies and procedures to ensure that third-party research distributed by a member “is reliable and objective” in addition to the review standard in current Rule 2711(h) that would also be required by the Notice Proposal and proposed rule change. The current standard requires a members to review non-independent third-party research for any “untrue statement of material fact or any false or misleading information that: (i) should be known from reading the report; or (ii) is known based on information otherwise possessed by the member.” Independent third-party research is excepted from the review requirements. SIFMA asked FINRA to eliminate the new requirement or, at a minimum, allow an exception for independent third-party research. Also, instead of requiring disclosure of the specific points of information delineated by the current rules, the Notice Proposal and the proposed rule change would include an overarching requirement that members disclose “any material conflict of interest that can reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third party research report.” SIFMA believed that the existing specific disclosure

requirements struck the appropriate balance and urged FINRA to eliminate the proposed new requirement.

We do not think it unreasonable to require screening procedures for third-party research to help ensure, for example, that the third-party provider is not being paid by the issuer or that the research has some kind of track record or good reputation. In fact, in a 2006 comment letter, SIFMA stated that firms should “demand high standards” from providers of third-party research.⁹⁸ However, FINRA has amended the proposal to prohibit a member from distributing third-party research that it knows or has reason to know is not objective or reliable. FINRA believes this standard more appropriately requires reasonable diligence without a duty of inquiry to definitively ascertain whether the research is, in fact, objective and reliable. As for disclosures, FINRA has built back in to the proposed rule change the specific required third-party disclosures in the current rule, but we also think it reasonable to overlay a principle to require disclosure of any material conflict that may have influenced the choice of the third-party provider or subject company.

Definitions

SIFMA and Dechert supported the provisions in the Notice Proposal to exclude from the definition of “research report” any communication on an open-end registered investment company that is not listed or traded on an exchange or a public direct participation program (“DPP”), but strongly urged FINRA to go further by carving-out written communications covering open-end exchange traded funds (“ETFs”) as well as

⁹⁸ See Letter from Michael D. Udoff, Vice President and Associate General Counsel, SIFMA, to Nancy M. Morris, Secretary, SEC, dated November 14, 2006.

private funds. These commenters argued that the same rationale that applies to the determination to exclude open-end investment companies also equally applies to ETFs and private funds (e.g., sales materials on ETFs and private funds are already subject to an extensive regulatory regime). Dechert stated that even though private fund sales literature is not subject to post-use review by FINRA, it does not need to be, because unlike open-end registered investment companies and public DPPs, it is only distributed to sophisticated investors. Dechert also believed that sales material on private funds are clearly prepared for marketing purposes and do not contain an analysis and, therefore, should not be subject to a regulatory regime that is intended to preserve the objectivity of analysis. Dechert further noted that sales literature cannot manipulate the price of a private fund because its value is calculated as the value of an open-end registered investment company using the NAV, not by the market. SIFMA also recommended that FINRA exclude from the definition of “research report” any type of periodic report or other communication for any managed client account, whether such account is “discretionary,” as the current rule provides, or non-discretionary in nature. SIFMA believed that the rationale for excluding discretionary accounts is equally applicable to non-discretionary accounts because clients who use these accounts, in general, rely on their individual money managers, not research reports, to make investment decisions in line with their goals.

FINRA believes the carve-out should be limited to sales material related to mutual funds, which trade at NAV and are subject to the filing requirements of FINRA’s advertising rules. ETFs, which are expanding in number and nature, are more susceptible to market-moving comments because they trade on an exchange and do not always trade

at NAV, particularly if an ETF holds thinly traded securities or securities that are traded on a foreign exchange, or if an ETF is highly concentrated in a single or small number of securities.

For many of the same reasons, FINRA has reconsidered the proposed exemption for research on DPPs. FINRA has recently become more aware of research reports on master limited partnerships (“MLPs”) that technically fall under the definition of a DPP due to questions that have arisen since FINRA’s new Rule 2210 (Communications with the Public) became effective in February 2013. MLPs more closely resemble individual stocks since they do not invest in an underlying portfolio of securities and therefore do not have a NAV and, in fact, FINRA has observed that research on MLPs largely resembles research on any other exchange-traded stock. FINRA notes, however, that not every communication concerning a DPP will be a research report – only those that include an analysis of the equity securities of the issuer and information sufficient upon which to base an investment decision would meet the definition of a research report. Sales material on private funds is not subject to FINRA’s advertising review filing requirements. To the extent that the sales material does not, as Dechert asserts, contain an analysis, then it would not meet the definition of a research report. FINRA further notes that the rules do not currently except research on private securities nor is there an institutional carve-out, so to except research on hedge funds, for example, might set up an inconsistency.

SIFMA stated that the proposed revisions to the definition of “investment banking services” are overly broad and that FINRA should retain the current definition for this term. SIFMA expressed concern that the added language would broaden the definition to

include personnel and departments not traditionally viewed as related to investment banking, including sales activities. As noted in the Purpose section, the current definition includes, without limitation, many common types of investment banking services. FINRA added the language “or otherwise acting in furtherance of” in the proposed rule change to further emphasize that the term should be broadly construed to cover all aspects of facilitating a public or private offering, as well as other investment banking activities. However, the new language is not intended to capture sales activities.

Pitch Book Materials

The proposed rule change requires policies and procedures reasonably designed to prohibit research analyst participation in pitches and other solicitation of investment banking services transactions. Supplementary Material .01 codifies previous guidance in Notice to Members 07-04, which sets out the principle that pitch materials may not contain any information about a member’s research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage. The supplementary material specifies that members may include the fact of coverage and the name of the research analyst because such information alone does not imply favorable coverage. The supplementary material also states FINRA’s view that including an analyst’s industry ranking in pitch materials implies favorable research because of the manner in which such rankings are compiled; i.e., they are voted on by institutional investors that tend to benefit from positive coverage of their holdings. SIFMA requested that FINRA revise the example provided in the proposed supplementary material to clarify what sort of materials are prohibited or provide an alternative example of prohibited pitch materials. SIFMA also asked that FINRA confirm that members may

disclose in pitch materials the fact that research coverage will be provided for a particular issuer.

FINRA believes the principle is clear and has included examples to illustrate FINRA's view of its application. Whether other information included in pitch materials violate the principle will depend on the facts and circumstances.

Effective Date

SIFMA requested that FINRA provide a 120-day grace period between the adoption of the proposal and the implementation of the proposed rules because some of the proposals will require major systems changes to firms' information technology systems, research report templates, and policies and procedures. FINRA is sensitive to the time firms will require to update their policies and procedures and systems to comply with the proposed rule change and will take those factors into consideration when establishing an implementation date.

Other Comments

Kolber supported the proposed change to exempt from FINRA's research analyst registration and qualification requirements those individuals who produce "research reports" but whose primary job function is something other than to provide investment research. The remainder of Kolber's comments with respect to the research registration and qualification requirements addressed more generally the scope and difficulty of the Series 86 examination, which is not the subject of the proposal. Kolber also stated that the definition of "research report" can be difficult to apply because it sets forth a standard and then lists several exceptions from the definition. FINRA notes that the structure is very similar to the definition of research report in Regulation AC and is not an

uncommon drafting method. Kolber's other comments are directed to the difficulty of distinguishing between the definitions of "sales literature" and "advertisement" in former NASD Rule 2210. That rule has since been replaced by consolidated FINRA Rule 2210, where those definitions no longer exist.

6. Extension of Time Period for Commission Action

FINRA does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.⁹⁹

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

Exhibit 2a. Regulatory Notice 08-55 (October 2008).

⁹⁹ 15 U.S.C. 78s(b)(2).

Exhibit 2b. A list of comment letters received in response to Regulatory Notice 08-55 (October 2008).

Exhibit 2c. Copies of the comment letters received in response to Regulatory Notice 08-55 (October 2008).

Exhibit 3. Joint Report by NASD and the NYSE on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules (December 2005).

Exhibit 5. Text of the proposed rule change.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2014-047)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt NASD Rule 2711 (Research Analysts and Research Reports) as a FINRA rule, with several modifications. The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 to create an exception from the research analyst qualification requirement. The proposed rule change would renumber NASD Rule 2711 as FINRA Rule 2241 in the consolidated FINRA rulebook.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As part of the process of developing a new consolidated rulebook ("Consolidated FINRA Rulebook"),³ FINRA is proposing to adopt in the Consolidated FINRA Rulebook NASD Rule 2711 (Research Analysts and Research Reports) with several modifications as FINRA Rule 2241. The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) to create an exception from the research analyst qualification requirements.

³ The current FINRA rulebook includes, in addition to FINRA Rules, (1) NASD Rules and (2) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

Background

NASD Rule 2711 and Incorporated NYSE Rule 472 (Communications with the Public) (“the Rules”) set forth requirements to foster objectivity and transparency in equity research and provide investors with more reliable and useful information to make investment decisions. The Rules were intended to restore public confidence in the objectivity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell those issuers’ securities. The integrity of research had eroded due to the pervasive influences of investment banking and other conflicts that became apparent during the market boom of the late 1990s.

The current NASD and Incorporated NYSE rules have no significant differences.⁴ In general, the Rules require disclosure of conflicts of interest in research reports and public appearances by research analysts. The Rules further prohibit conflicted conduct – investment banking personnel involvement in the content of research reports and determination of analyst compensation, for example – where the conflicts are too pronounced to be cured by disclosure. Several of the Rules’ provisions implement provisions of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), which mandates separation between research and investment banking, proscribes conduct that could

⁴ The one substantive difference between the rules involves the recordkeeping obligations when a research analyst makes a public appearance. Incorporated NYSE Rule 472(k)(2) requires a record of the public appearance to be made within 48 hours and include specific information about the nature of the appearance and applicable disclosures. NASD Rule 2711(h)(12) provides that members must maintain records of public appearances sufficient to demonstrate compliance with the applicable disclosure requirements.

compromise a research analyst's objectivity and requires specific disclosures in research reports and public appearances.⁵

NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) require any person associated with a member and who functions as a research analyst to be registered as such and pass the Series 86 and 87 exams, unless an exemption applies. NASD Rule 1050 defines "research analyst" as "an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report." Incorporated NYSE Rule 344 has a substantially similar definition.

In December 2005, in response to a Commission Order, FINRA and the NYSE submitted to the Commission a joint report on the operation and effectiveness of the research analyst conflict of interest rules ("Joint Report").⁶ Among other things, the Joint Report analyzed the impact of the Rules based on academic studies, media reports and commentary. The Joint Report concluded that the Rules have been effective in helping to restore integrity to research by minimizing the influence of investment banking and promoting transparency of other potential conflicts of interest. Evidence from academic studies, among other sources, further suggested that investors are benefiting from more balanced and accurate research to aid their investment decisions. A January 2012 GAO report on securities research ("GAO Report") also concluded that empirical results

⁵ 15 U.S.C. 78q-6.

⁶ 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.finra.org/web/groups/industry/@ip/@issues/@rar/documents/industry/p015803.pdf>.

suggest the Rules have resulted in increased analyst independence and weakened the influence of conflicts of interest on analyst recommendations.⁷

The Joint Report also recommended changes to the Rules to strike an even better balance between ensuring objective and reliable research on the one hand, and permitting the flow of information to investors and minimizing costs and burdens to members on the other.⁸ The recommendations resulted from a comprehensive review of the Rules. In evaluating the Rules, FINRA staff considered several analytical touchstones: whether a provision was accomplishing its intended purpose; findings from examinations, sweeps and enforcement actions; interpretive requests and member questions; a comparison of provisions of the “Global Settlement”;⁹ potential gaps or overbreadth in the provisions; and input from members and industry groups. The proposed rule change maintains those

⁷ United States Government Accountability Office, Securities Research, Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest, January 2012.

⁸ FINRA previously filed two proposed rule changes to implement recommendations from the Joint Report. On October 17, 2006, FINRA filed for immediate effectiveness a proposed rule change to codify previously issued interpretive guidance. See Securities Exchange Act Release No. 54616 (October 17, 2006), 71 FR 62331 (October 24, 2006) (Notice of Filing File Nos. SR-NYSE-2006-77; SR-NASD-2006-112). However, FINRA withdrew the second proposal in anticipation of filing this more comprehensive consolidated proposed rule change. See Securities Exchange Act Release No. 55072 (January 9, 2007), 72 FR 2058 (January 17, 2007) (Notice of Filing File Nos. SR-NYSE-2006-78; SR-NASD-2006-113) (Withdrawn October 25, 2012).

⁹ In 2003, federal and state authorities and self-regulatory organizations reached a settlement with 10 of the nation’s largest broker-dealers to resolve allegations of misconduct involving conflicts of interest between their research analysts and investment bankers. In 2004, two additional firms settled substantively under the same terms, which included provisions to effectively separate research from investment banking.

aforementioned objectives and therefore incorporates many of the recommendations in the Joint Report not already incorporated into the current rules.¹⁰

The proposed rule change would retain the core provisions of the current rules, broaden the obligations on members to identify and manage research-related conflicts of interest, restructure the rules to provide some flexibility in compliance without diminishing investor protection, extend protections where gaps have been identified, and provide clarity to the applicability of existing rules. Where consistent with protection of users of research, the proposed rule change reduces burdens: for example, it would modify or eliminate requirements (e.g., quiet periods and the annual attestation), expand the exemption for firms with limited investment banking activity, and create a new limited exemption from the registration requirements for “research reports” produced by persons whose primary job function is something other than producing research. Taken together, FINRA believes the proposed amendments will result in rules that more

¹⁰ FINRA has not incorporated all of the Joint Report recommendations in the proposed rule change. As discussed infra at 72, FINRA is not incorporating the recommendation to exclude direct participation programs from the definition of “research report.” FINRA previously addressed a recommendation to provide guidance with respect to the road show prohibition. FINRA set forth guidance in Regulatory Notice 07-04 that it is permissible for research analysts to listen to or view a live webcast of a road show or other widely attended presentation to investors or the sales force from a remote location. That guidance remains applicable to the proposed rule change. As discussed infra at 21, FINRA is not incorporating the recommendation to completely eliminate the quiet period after secondary offerings. FINRA also is not incorporating the recommendation to expand the exceptions to the personal trading restrictions because, as discussed infra at 27, FINRA is proposing to replace the prescriptive restrictions with a requirement to establish, maintain and enforce policies and procedures that obviate the need to set out specific exceptions to those provisions. In addition, as discussed infra at 34-35, FINRA is not proposing to replace the current disclosure requirements with a prominent warning on the cover of a research report that conflicts of interest exist, together with information on how the reader may obtain more detail about the conflicts on the member’s website.

effectively and efficiently achieve their intended goals of objective, transparent and useful research for investors. The proposed rule change reflects input from FINRA advisory committees and market participants and includes changes made in response to comments received to an earlier consolidated rule proposal set forth in Regulatory Notice 08-55. The substantive proposed changes to the existing research rules are described below.¹¹

Definitions

The proposed rule change mostly maintains the definitions in current NASD Rule 2711, with the following modifications:

- minor changes to the definition of “investment banking services” to clarify that such services include all acts in furtherance of a public or private offering on behalf of an issuer.¹²
- clarification in the definition of “research analyst account” that the definition does not apply to a registered investment company over which a research analyst has discretion or control, provided that the research analyst or a member of that research analyst’s household has no financial interest in the investment company, other than a performance or management fee.¹³

¹¹ For economy, the discussion generally refers only to NASD Rules; however, those references apply equally to the corresponding Incorporated NYSE Rules.

¹² See proposed FINRA Rule 2241(a)(5). The current definition includes, without limitation, many common types of investment banking services. FINRA is proposing to add the language “or otherwise acting in furtherance of” either a public or private offering to further emphasize that the term “investment banking services” is meant to be construed broadly.

¹³ See proposed FINRA Rule 2241(a)(9).

- exclusion from the definition of “research report” of communications concerning open-end registered investment companies that are not listed or traded on an exchange (“mutual funds”).¹⁴
- move into the definitional section the definitions of “third-party research report” and “independent third-party research report” that are now in a separate provision of the rules.¹⁵

The current rules define “research analyst account” to include any account over which a research analyst or member of the research analyst’s household has a financial interest, or over which such person has discretion or control, other than an investment company registered under the Investment Company Act of 1940. The purpose of the exception is to accommodate circumstances where a research analyst also manages a registered investment company; otherwise, every transaction in the investment company’s fund would be subject to personal trading restrictions, including any blackout periods a firm may establish, creating substantial logistical difficulties in operating the fund. The proposed change is intended to clarify that the exception does not apply where the research analyst account has a financial interest in the fund, other than a performance or management fee. In those circumstances, FINRA believes the conflict is too serious because the research analyst account could benefit more directly by taking positions in advance of publishing research or making a public appearance that could affect the price of the holdings.

¹⁴ See proposed FINRA Rule 2241(a)(11).

¹⁵ See proposed FINRA Rules 2241(a)(3) and (13). FINRA believes it creates a more streamlined and user friendly rule to combine defined terms in a single definitional section.

“Research report” currently is defined in Rule 2711(a)(9) as a “written (including electronic) communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.” Since shares of mutual funds are “equity securities” as defined in Section 3(a)(11) of the Exchange Act, a written communication that contains an analysis of mutual fund securities and information sufficient upon which to base an investment decision technically is covered by the definition.

However, FINRA believes that communications concerning mutual funds should be excluded from the definition of “research report.” Sales material regarding mutual funds is already subject to a separate regulatory regime, including FINRA Rule 2210 and Securities Act of 1933 (“Securities Act”) Rule 482, and, subject to certain exceptions, retail communications regarding registered investment companies must be filed with FINRA within 10 business days of first use.¹⁶ The extensive content standards of these rules, combined with the filing and review of mutual fund sales material by FINRA staff, substantially reduce the likelihood that such material will include materially misleading

¹⁶ See FINRA Rule 2210(c)(3)(A). A retail communication concerning a registered investment company that includes a performance ranking or performance comparison of the investment company with other investment companies that is not generally published or is created by the fund or its affiliates must be filed with FINRA at least 10 business days prior to first use or publication. FINRA Rule 2210(c)(7) lists categories of member communications that are excluded from the rule’s filing requirements, including certain retail communications concerning investment companies. For example, FINRA Rule 2210(c)(7)(I) excludes from the rule’s filing requirements certain independently prepared reprints or excerpts of articles or reports concerning investment companies. However, this filing exclusion only applies to articles or reports where the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint, and neither the member using the reprint nor any underwriter or issuer of a security mentioned in the reprint has commissioned the reprinted article or report.

information about the funds. Moreover, FINRA does not believe that the conflicts underpinning the research rules are manifest to the same extent with respect to reports on mutual funds. For example, a mutual fund's share price is determined by the fund's net asset value ("NAV"), which is based on the total value of the fund's portfolio. Because most mutual funds hold a large number of individual securities, it is much less likely that a report on a mutual fund would affect the fund's NAV to the same extent that a research report on a single stock might impact its share price.

Identifying and Managing Conflicts of Interest

The proposal creates a new section entitled "Identifying and Managing Conflicts of Interest." This section contains an overarching provision that requires members to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts and the interaction between research analysts and persons outside of the research department, including investment banking and sales and trading personnel, the subject companies and customers.¹⁷ A second provision sets forth more specifically what those written policies and procedures must address. They must promote objective and reliable research that reflects the truly held opinions of research analysts and prevent the use of research or research analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers.¹⁸ These provisions, therefore, set out the fundamental obligation for a member to establish and maintain a

¹⁷ See proposed FINRA Rule 2241(b)(1).

¹⁸ See proposed FINRA Rule 2241(b)(2).

system to identify and mitigate conflicts to foster integrity and fairness in its research products and services. The provisions are also intended to require firms to be more proactive in identifying and managing conflicts as new research products, affiliations and distribution methods emerge.

The proposed rule change then sets forth minimum requirements for those written policies and procedures. This approach allows for some flexibility to manage identified conflicts, with some specified prohibitions and restrictions where disclosure does not adequately mitigate them. Most of the minimum requirements have been experience tested and found effective.

Sarbanes-Oxley mandates specific rules to prohibit or restrict conduct related to the preparation, approval and distribution of research reports and the determination of research analyst compensation. Thus, the proposal requires members to establish, maintain and enforce written policies and procedures reasonably designed specifically to achieve compliance with those Sarbanes-Oxley requirements. This approach provides firms with more flexibility to adopt policies and procedures to effectuate those mandates in a manner consistent with the member's size and organizational structure. The proposed rule changes also goes beyond Sarbanes-Oxley to require additional written policies and procedures that further the separation between research and not only investment banking, but also other non-research personnel, such as sales and trading, that may have interests that conflict with independent, unbiased research.

Thus, the proposed rule change mostly retains or slightly modifies the current structural safeguards that the Joint Report found effective to promote analyst independence and objective research, but in the form of mandated written policies and

procedures with some baseline proscriptions.¹⁹ FINRA believes this approach will provide the same investor protections as the current rules, but impose less cost than a pure prescriptive approach by requiring firms to adopt a compliance system that aligns with their particular structure, business model and philosophy. FINRA notes that the approach is consistent with FINRA's general supervision rule, which similarly provides firms flexibility to establish and maintain supervisory programs best suited to their business models, reasonably designed to achieve compliance with applicable federal securities law and regulations and FINRA rules.²⁰

¹⁹ Among the structural safeguards, FINRA believes separation between investment banking and research is of particular importance. As such, while the proposed rule change does not mandate physical separation between the research and investment banking departments (or other person who might seek to influence research analysts), FINRA would expect such physical separation except in extraordinary circumstances where the costs are unreasonable due to a firm's size and resource limitations. In those instances, a firm must implement written policies and procedures, including information barriers, to effectively achieve and monitor separation between research and investment banking personnel.

²⁰ See NASD Rule 3010, recently adopted with changes as a consolidated FINRA rule by Securities Exchange Act Release No. 71179 (December 23, 2013), 78 FR 79542 (December 30, 2013) (Order Approving File No. SR-FINRA-2013-025). The consolidated rule becomes effective December 1, 2014. FINRA further notes that the policies and procedures approach is consistent with the effective practices highlighted by FINRA in its Report on Conflicts of Interest, among them that firms should implement a robust conflicts management framework that includes structures, processes and policies to identify and manage conflicts of interest. See Report on Conflicts of Interest, FINRA (October 2013) at 5, available at <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf>. The proposed changes also help to harmonize with approaches in international jurisdictions, such as the rules of the Financial Conduct Authority in the United Kingdom. See COBS 12.2.5 R, The Financial Conduct Authority Handbook, available at <http://fshandbook.info/FS/html/handbook/COBS/12/2>.

Prepublication Review

The required policies and procedures must, at a minimum, be reasonably designed to prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel.²¹ Thus, this provision maintains the current prohibition on prepublication review by investment banking personnel, but eliminates the exception in paragraph (b)(3) of Rule 2711 that permits pre-publication review of research by investment banking to verify the factual accuracy of information in a research report. FINRA believes that review of facts in a report by investment banking is unnecessary in light of the numerous other sources available to verify factual information, including the subject company, and only raises concerns about the objectivity of the report. Such review may invite pressure on a research analyst from such personnel that could be difficult to monitor. Factual review by investment banking personnel is not permitted under the terms of the Global Settlement, and FINRA staff is not aware of any evidence that the factual accuracy of research produced by Global Settlement firms has suffered. Moreover, legal and compliance can adequately perform a conflict review without sharing draft research reports with investment banking.

The proposal requires policies and procedures reasonably designed to at least restrict prepublication review by other non-research personnel, other than legal and compliance personnel. Thus, a firm must specify in its policies and procedures the

²¹ See proposed FINRA Rule 2241(b)(2)(A).

circumstances, if any, where such review would be permitted as necessary and appropriate; for example, where non-research personnel are best situated to verify select facts or where administrative personnel review for formatting. FINRA notes that members still would be subject to the overarching requirement to have policies and procedures reasonably designed to effectively manage conflicts of interest between research analysts and those outside of the research department.

Coverage Decisions

The required policies and procedures must be reasonably designed to restrict or limit input by investment banking department into research coverage decisions to ensure that research management independently makes all final decisions regarding the research coverage plan.²² This provision makes express FINRA's interpretation that the separation requirements in current Rule 2711(b)(1) prohibit investment banking personnel from making any final coverage decisions. The proposed provision does not preclude investment banking personnel from conveying customer interests or providing input into coverage considerations, so long as final decisions regarding the coverage plan are made by research management.

Supervision and Control of Research Analysts

The required policies and procedures must be reasonably designed to prohibit persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination.²³ The provision is substantively the same as current Rule 2711(b)(1),

²² See proposed FINRA Rule 2241(b)(2)(B).

²³ See proposed FINRA Rule 2241(b)(2)(C).

a core structural separation requirement that FINRA believes is essential to safeguarding analyst objectivity.

Research Budget Determinations

The required policies and procedures must be reasonably designed to limit determination of research department budget to senior management, excluding senior management engaged in investment banking services activities.²⁴ This provision makes express FINRA's interpretation that the separation requirements of current Rule 2711(b)(1) prohibit investment banking personnel from making any determination of research budget decisions.

Compensation

The required policies and procedures must be reasonably designed to prohibit compensation based upon specific investment banking services transactions or contributions to a member's investment banking services activities.²⁵ The policies and procedures further must require a committee that reports to the member's board of directors – or if none exists, a senior executive officer – to review and approve at least annually the compensation of any research analyst who is primarily responsible for preparation of the substance of a research report. The committee may not have representation from a member's investment banking department. The committee must consider, among other things, the productivity of the research analyst and the quality of his or her research and must document the basis for each research analyst's

²⁴ See proposed FINRA Rule 2241(b)(2)(D).

²⁵ See proposed FINRA Rule 2241(b)(2)(E).

compensation.²⁶ These provisions are consistent with the requirements in current Rule 2711(d).

Information Barriers

The required policies and procedures must be reasonably designed to establish information barriers or other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision.²⁷ FINRA believes the other policies and procedures required by the proposed rule change to identify and manage research-related conflicts of interest should effectively result in compliance with this Sarbanes-Oxley-based provision. However, FINRA is including the provision to emphasize that the conflicts management must extend to persons other than investment banking personnel, including sales and trading department personnel, who may be placed in a position to supervise or influence the content of research reports or public appearances.

Retaliation

The required policies and procedures must be reasonably designed to prohibit direct or indirect retaliation or threat of retaliation against research analysts employed by the member or its affiliates by persons engaged in investment banking services activities or other employees as the result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may

²⁶ See proposed FINRA Rule 2241(b)(2)(F).

²⁷ See proposed FINRA Rule 2241(b)(2)(G).

adversely affect the member's present or prospective business interests.²⁸ This provision is consistent with current Rule 2711(j), except that it extends the retaliation prohibition to employees other than investment banking personnel. FINRA believes it is essential to a research analyst's independence and objectivity that no person employed by a member that is in a position to retaliate or threaten to retaliate should be permitted to do so based on the content of a research report or public appearance.

Quiet Periods

The required policies and procedures must be reasonably designed to define quiet periods of a minimum of 10 days after an initial public offering, and a minimum of three days after a secondary offering, during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer if the member has participated as an underwriter or dealer in the initial public offering or, with respect to the quiet periods after a secondary offering, as a manager or co-manager of that offering.²⁹ This provision represents a significant change from the current rules, which impose a 40-day quiet period on a member acting as manager or co-manager of an IPO, a 25-day quiet period on a member participating as an underwriter or dealer (other than manager or co-manager) in an IPO, and a 10-day quiet

²⁸ See proposed FINRA Rule 2241(b)(2)(H). This provision is not intended to limit a member's authority to discipline or terminate a research analyst, in accordance with the member's written policies and procedures, for any cause other than writing an adverse, negative, or otherwise unfavorable research report or for making similar comments during a public appearance.

²⁹ See proposed FINRA Rule 2241(b)(2)(I). Consistent with the Jumpstart Our Business Startups Act ("JOBS Act"), those quiet periods do not apply following the IPO or secondary offering of an Emerging Growth Company ("EGC"), as that term is defined in Section 3(a)(80) of the Exchange Act.

period on a member acting as manager or co-manager of a secondary offering. As mentioned above, the quiet periods do not apply to EGCs.

With respect to these quiet-period provisions, the proposed rule change reduces the current 40-day quiet period for IPOs to a minimum of 10 days after the completion of the offering for any member that participated as an underwriter or dealer, and reduces the 10-day secondary offering quiet period to three days after the completion of the offering for any member that participated as a manager or co-manager in the secondary offering.

The lengthier quiet period for managers and co-managers was intended to allow other voices to publicly analyze and value a subject company before members most vested in the success of the offering expressed a view in their reports and public appearances. However, in light of the objectivity safeguards in other provisions of the research rules and the certification requirement of SEC Regulation AC, FINRA believes it is no longer necessary to impose a longer period on managers and co-managers. Both the Joint Report and the GAO Report noted that analysts have been issuing less optimistic recommendations since the regulatory reforms, particularly at firms involved in underwriting subject company securities.³⁰ FINRA believes that the separation, disclosure and certification requirements in the rules and Regulation AC have had greater impact on the objectivity of research than maintaining quiet periods during which research may not be distributed and research analysts may not make public appearances. FINRA has observed – and media reports have documented – instances when a manager or co-manager of an IPO has initiated coverage of the subject company with a “hold” or

³⁰ See Joint Report, supra note 6 at 17-20; see GAO Report, supra note 7 at 12-15.

even “sell” rating once the quiet period ended.³¹ These examples buttress FINRA’s belief that the other provisions of the rules and Regulation AC have been effective in deterring biased research. FINRA also notes that there is a cost to investors when they are deprived of information and analysis during quiet periods.

Accordingly, FINRA is proposing to reduce all of the quiet periods after IPOs and secondary offerings. By doing so, FINRA believes the proposed rule change would promote more information flow to investors without jeopardizing the objectivity of research. As reflected in the Joint Report, FINRA was in favor of completely eliminating the quiet periods around secondary offerings; however, SEC staff has since indicated its view that the Sarbanes-Oxley reference to “public offering of securities”³² encompasses both initial public offerings and secondary offerings and therefore mandates a quiet period after such public offerings, except for EGCs. FINRA will read with interest comments with evidence that suggests that maintaining longer quiet periods for manager and co-managers after the IPO of a non-EGC issuer would provide a meaningful benefit to investors.

As recommended in the Joint Report, the proposed rule change also eliminates the current quiet periods 15 days before and after the expiration, waiver or termination of a lock-up agreement. FINRA believes that research issued during such periods potentially offers valuable market information, and the other provisions of the research rules and SEC Regulation AC provide sufficient protection that such research will reflect the

³¹ See Facebook Shares No Lock for Pop After Quiet Period, available at <http://blogs.wsj.com/marketbeat/2012/06/27/facebook-shares-no-lock-for-pop-after-quiet-period/>; see also Warburg Analyst Advises Investors to Sell JetBlue, available at <http://articles.latimes.com/2002/may/08/business/fi-wrap8>.

³² 15 U.S.C 78o-6(a)(2).

analyst's honest beliefs and be free from other conflicts that would undermine the value or integrity of research issued during these periods. FINRA understands from some underwriters that issuers will time release of negative news to occur during these quiet periods, thereby depriving investors of timely analysis of the impact of the news on their holdings. FINRA also notes that the change will bring consistency to the application of the rules, irrespective of the subject company, because, as noted above, recent amendments implementing the JOBS Act exempt research regarding EGCs from the current quiet periods.³³

Solicitation and Marketing

In addition, the proposed rule change requires firms to adopt written policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity.³⁴ This includes the existing prohibitions on participation in pitches and other solicitations of investment banking services transactions and road shows and other marketing on behalf of issuers related to such transactions. FINRA notes that consistent with existing guidance analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.³⁵

³³ FINRA notes that the proposed changes to the quiet periods do not affect any quiet periods that may be required under federal law.

³⁴ See proposed FINRA Rule 2241(b)(2)(L).

³⁵ See NASD Notice to Members 07-04 (January 2007) and NYSE Information Memo 07-11 (January 2007).

Pursuant to the recent amendments implementing the JOBS Act, the prohibition on participation in pitch meetings does not apply to a research analyst that attends a pitch meeting in connection with an IPO of an EGC that is also attended by investment banking personnel. However, FINRA notes that research analysts still are prohibited from soliciting an investment banking services transaction or promising favorable research during permissible attendance at those pitch meetings.³⁶ The proposed rule change also adds Supplementary Material .01, which codifies the existing interpretation that the pitch provision prohibits members from including in pitch materials any information about a member's research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage.³⁷ By way of example, the Supplementary Material explains that FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. The Supplementary Material further notes that a member would be permitted to include in the pitch materials the fact of coverage and the name of the research analyst, since that information alone does not imply favorable coverage.

Joint Due Diligence and Other Interactions with Investment Banking

The proposed rule establishes a new proscription with respect to joint due diligence activities – i.e., due diligence by the research analyst in the presence of investment banking department personnel – during a specified time period. Specifically,

³⁶ See Jumpstart Our Business Startups Act, Frequently Asked Questions About Research Analysts and Underwriters, available at <http://www.sec.gov/divisions/marketreg/tmjjobsact-researchanalystsfaq.htm>.

³⁷ See proposed FINRA Rule 2241.01 and Notice to Members 07-04 (January 2007).

proposed Supplementary Material .02 states that FINRA interprets the overarching principle requiring members to, among other things, establish, maintain and enforce written policies and procedures that address the interaction between research analysts, banking and subject companies, to prohibit the performance of joint due diligence prior to the selection of underwriters for the investment banking services transaction. FINRA understands that in some instances, due diligence activities take place even before an issuer has awarded the mandate to manage or co-manage an offering. FINRA believes there is heightened risk in those circumstances that investment bankers may pressure analysts to produce favorable research that may bolster the firm's bid to become an underwriter for the offering. Once the mandate has been awarded, FINRA believes joint due diligence may take place in accordance with appropriate policies and procedures to guard against interactions to further the interests of the investment banking department. At that time, FINRA believes that the efficiencies of joint due diligence outweigh the risk of pressure on research analysts by investment banking. Also, FINRA understands that typically an analyst that is participating in due diligence activities will not be publishing research at that time due to quiet periods under the offering rules of the Securities Act or because the analyst has been brought "over the wall." FINRA notes that this provision is consistent with restrictions in the Global Settlement.

The proposed rule continues to prohibit investment banking department personnel from directly or indirectly directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction, and directing a research analyst to engage in any communication with a current or prospective customer about an

investment banking services transaction.³⁸ Supplementary Material .03 clarifies that three-way meetings between research analysts and a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction are prohibited by this provision.³⁹ FINRA believes that the presence of investment bankers or issuer management could compromise a research analyst's candor when talking to a current or prospective customer about a deal. Supplementary Material .03 also retains the current requirement that any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

Promises of Favorable Research and Prepublication Review by Subject Company

The proposal maintains the current prohibition against promises of favorable research, a particular research recommendation, rating or specific content as inducement for receipt of business or compensation.⁴⁰ It further prohibits prepublication review of a research report by a subject company for purposes other than verification of facts.⁴¹

³⁸ See proposed FINRA Rule 2241(b)(2)(M). FINRA notes that this provision does not prohibit investment banking personnel from forwarding to a research analyst the name of a prospective investor in an investment banking transaction, provided that the research analyst retains discretion whether to contact the investor and for the content of any discussion that ensues. See Regulatory Notice 12-49 (November 2012).

³⁹ See proposed FINRA Rule 2241.03.

⁴⁰ See proposed FINRA Rule 2241(b)(2)(K). FINRA provided additional guidance on the current provision, NASD Rule 2711(e), in Regulatory Notice 11-41 (September 2011).

⁴¹ See proposed FINRA Rule 2241(b)(2)(N).

Supplementary Material .05 maintains the current guidance applicable to the prepublication submission of a research report to a subject company. Specifically, sections of a draft research report may be provided to non-investment banking personnel or the subject company for factual review, provided: (1) that the draft section does not contain the research summary, research rating or price target; (2) a complete draft of the report is provided to legal or compliance personnel before sections are submitted to non-investment banking personnel or the subject company; and (3) any subsequent proposed changes to the rating or price target are accompanied by a written justification to legal or compliance and receive written authorization for the change. The member also must retain copies of any draft and the final version of the report for three years.⁴²

Personal Trading Restrictions

The proposal provides for a more encompassing and flexible supervisory approach with respect to research analyst account trading in securities of companies the research analyst covers. The current rules impose specific blackout periods during which a research analyst account may not trade covered securities and require pre-approval by legal and compliance of transactions in covered securities by persons who oversee research analysts. The current rules also provide several exceptions to the blackout periods, including where a report or change in rating or price target results from “significant news or a significant event concerning the subject company.” In addition, the blackout periods do not apply to: (1) transactions in the securities of a registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; or (2) purchases or sales of securities in other investment funds

⁴² See proposed FINRA Rule 2241.05.

over which neither the research analyst nor a member of a research analyst's household has any investment discretion or control, provided that the research analyst account collectively owns interests representing no more than 1% of the fund's assets and that the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of businesses as companies in the research analyst's coverage universe. The rules further prohibit a research analyst account from purchasing or selling any security or any option or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member. Legal or compliance may authorize transactions otherwise prohibited by the rules based on an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that the authorization is in accordance with policies and procedures reasonably designed to avoid a conflict between the professional responsibilities of the research analyst and his or her personal trading and that the member maintains for three years written records documenting the justification for permitting the transaction.

The proposal instead requires that firms establish written policies and procedures that restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst.⁴³ Such policies and procedures must ensure that research analyst accounts, supervisors of research analysts and associated persons with the ability to influence the content of research reports do not benefit in their trading from knowledge of the content or timing of a research report before the intended

⁴³ See proposed FINRA Rule 2241(b)(2)(J).

recipients of such research have had a reasonable opportunity to act on the information in the research report.⁴⁴ The proposal maintains, as minimum standards, the current prohibitions on research analysts receiving pre-IPO shares in the sector they cover and trading against their most recent recommendations. However, members may define financial hardship circumstances, if any, in which a research analyst would be permitted to trade against his or her most recent recommendation.⁴⁵ While the proposed rule change does not include a recordkeeping requirement, FINRA expects members to evidence compliance with their policies and procedures and retain any related documentation in accordance with FINRA Rule 4511. The proposed rule change includes Supplementary Material .10, which provides that FINRA would not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.⁴⁶ This provision is intended to provide a mechanism by which a firm's analysts can divest their holdings to comply with a more restrictive personal trading policy without violating the trading against recommendation provision in circumstances where an analyst has, for example, a "buy" rating on a subject company.

⁴⁴ See proposed FINRA Rule 2241(b)(2)(J)(i).

⁴⁵ See proposed FINRA Rule 2241(b)(2)(J)(ii).

⁴⁶ See proposed FINRA Rule 2241.10.

FINRA believes these provisions will provide enhanced investor protection, while allowing firms to tailor management of conflicts related to personal trading of subject company securities to their particular size and business model. The enhanced protection results from expanding the scope of persons covered by the provisions to include not only research analyst accounts, but also those of supervisors and persons with an ability to influence the content of research reports. The proposal also preserves the key protections of the current rules by preventing research analysts from trading ahead of their customers and by generally requiring consistency between personal trading and recommendations to customers.

Content and Disclosure in Research Reports

With a couple of modifications, the proposed rule change maintains the current disclosure requirements. Thus, the proposed rule change maintains the mandated Sarbanes-Oxley disclosure requirements,⁴⁷ as well as additional disclosure obligations – meanings and distribution of ratings and price charts, for example – that are designed to provide investors with useful information on which to base their investment decisions. The proposed rule change also maintains the requirement that disclosures be presented on the front page of the research report or the front page must refer to the page on which the disclosures are found. Electronic research reports may provide a hyperlink directly to the required disclosures. All disclosures and references to required disclosures must be clear, comprehensive and prominent.⁴⁸

⁴⁷ See Section 501 Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

⁴⁸ See proposed FINRA Rule 2241(c)(6).

The proposed rule change adds a requirement that a member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in its research reports are based on reliable information.⁴⁹ FINRA has included this provision because it believes members should have policies and procedures to foster verification of facts and trustworthy research on which investors may rely. The policies and procedures also must be reasonably designed to ensure that any recommendation or rating has a reasonable basis in fact and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation or rating.⁵⁰

In addition, the proposed rule change would require a member to disclose in any research report at the time of publication or distribution of the report:⁵¹

- if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;⁵²

⁴⁹ See proposed FINRA Rule 2241(c)(1)(A).

⁵⁰ See proposed FINRA Rule 2241(c)(1)(B). This is substantively the same as NASD Rule 2711(h)(7) but in the form of policies and procedures.

⁵¹ See proposed FINRA Rule 2241(c)(4). In comparing the proposed disclosure provisions to those in NASD Rule 2711, FINRA notes that in some instances the proposed rule change makes minor word or grammatical changes, uses streamlined language or has moved some text to Supplementary Material, but does not intend to change the substantive disclosure requirements. In those circumstances, FINRA considers the proposed disclosure provisions to be "substantively the same" as the current provisions.

⁵² See proposed FINRA Rule 2241(c)(4)(A). This is substantively the same as NASD Rule 2711(h)(1).

- if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;⁵³
- if the member or any of its affiliates: (i) managed or co-managed a public offering of securities for the subject company in the past 12 months; (ii) received compensation for investment banking services from the subject company in the past 12 months; or (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;⁵⁴
- if, as of the end of the month immediately preceding the date of publication or distribution of a research report (or the end of the second most recent month if the publication or distribution date is less than 30 calendar days after the end of the most recent month), the member or its affiliates have received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;⁵⁵
- if the subject company is, or over the 12-month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, must be identified as either investment banking services, non-

⁵³ See proposed FINRA Rule 2241(c)(4)(B). This is substantively the same as NASD Rule 2711(h)(2)(A)(i)a.

⁵⁴ See proposed FINRA Rule 2241(c)(4)(C). This is substantively the same as NASD Rule 2711(h)(2)(A)(ii).

⁵⁵ See proposed FINRA Rule 2241(c)(4)(D). This provision, together with proposed FINRA Rule 2241.04, is substantively the same as NASD Rules 2711(h)(2)(A)(iii)a., (iv) and (v).

investment banking services, non-investment banking securities-related services or non-securities services;⁵⁶

- if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report;⁵⁷ and
- if the research analyst received any compensation from the subject company in the previous 12 months.⁵⁸

The proposal also expands upon the current “catch all” disclosure, which mandates disclosure of any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know of at the time of the publication or distribution of a research report or public appearance.⁵⁹ The proposed rule change goes beyond the existing provision by requiring disclosure of material conflicts known not only by the research analyst, but also by any “associated person of the member with the ability to influence the content of a research report.”⁶⁰ In so doing, the proposed rule change would capture material conflicts of interest that, for example, only a supervisor or the head of research may be aware of. The “reason to know” standard would not impose a duty of inquiry on the research analyst or others who can influence

⁵⁶ See proposed FINRA Rule 2241(c)(4)(E). This is substantively the same as NASD Rule 2711(h)(2)(A)(iii)b.

⁵⁷ See proposed FINRA Rule 2241(c)(4)(G). This is substantively the same as NASD Rule 2711(h)(8).

⁵⁸ See proposed FINRA Rule 2241(c)(4)(H). This is substantively the same as NASD Rule 2711(h)(2)(A)(i)b.

⁵⁹ For example, FINRA would consider it to be a material conflict of interest if the research analyst or a member of the research analyst’s household serves as an officer, director or advisory board member of the subject company.

⁶⁰ See proposed FINRA Rule 2241(c)(4)(I).

the content of a research report. Rather, it would cover disclosure of those conflicts that should reasonably be discovered by those persons in the ordinary course of discharging their functions.

The proposed rule change also modifies the requirement to disclose when a member or its affiliates own securities of the subject company to include any “significant financial interest in the debt or equity of the subject company,” including, at a minimum, beneficial ownership of 1% or more of any class of common equity securities of the subject company.⁶¹ Thus, among other things, the proposal delineates the obligation to disclose significant debt holdings as a material conflict of interest that currently is captured by the “other material conflict of interest” provision referenced above. FINRA believes that an equity research report that analyzes the creditworthiness of the subject company could impact the price of the company’s debt securities, and therefore a material conflict exists where the member or its affiliates maintains significant debt holdings in the subject company. The determination of beneficial ownership would continue to be based upon the standards used to compute ownership for the purposes of the reporting requirements under Section 13(d) of the Exchange Act.

The proposal retains the general exception for disclosure that would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.⁶² The proposal also continues to permit a member that distributes a research report covering six or more companies (compendium report) to

⁶¹ See proposed FINRA Rule 2241(c)(4)(F). The requirement to disclose beneficial ownership of 1% or more of any class of common equity securities of the subject company is the same as NASD Rule 2711(h)(1)(B).

⁶² See proposed FINRA Rule 2241(c)(5).

direct the reader in a clear manner as to where the applicable disclosures can be found. An electronic compendium research report may hyperlink to the disclosures. A paper compendium report must include a toll-free number or a postal address where the reader may request the disclosures. In addition, paper research reports may include a web address where the disclosures can be found.⁶³

As detailed in the Joint Report, FINRA believes that a web-based disclosure approach would be at least as effective and a more efficient means to inform investors of conflicts of interests. To that end, FINRA recommended – and eventually proposed in SR-NASD-2006-113 – to permit members, in lieu of publication in the research report itself, to disclose their conflicts of interest by including a prominent warning on the cover of a research report that conflicts of interest exist, together with information on how the reader may obtain more detail about these conflicts on the member’s website. However, FINRA has subsequently been informed by SEC staff that it believes such a web-based disclosure approach would not be consistent with the Sarbanes-Oxley requirement “to disclose [conflicts of interest] in each report”;⁶⁴ therefore, FINRA has not re-proposed it here.

Disclosures in Public Appearances

The proposal groups in a separate provision the disclosures required when a research analyst makes a public appearance.⁶⁵ The required disclosures remain

⁶³ See proposed FINRA Rule 2241(c)(7). This is substantively the same as Rule 2711(h)(11).

⁶⁴ 15 U.S.C 78o-6(b).

⁶⁵ See proposed FINRA Rule 2241(d).

substantively the same as under the current rules,⁶⁶ with one exception: consistent with the modification referenced above with respect to disclosure in research reports, a research analyst is similarly required to disclose in a public appearance if a member or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company, as computed in accordance with Section 13(d) of the Exchange Act. Unlike in research reports, the “catch all” disclosure requirement in public appearances applies only to a conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance and does not extend to conflicts that an associated person with the ability to influence the content of a research report or public appearance knows or has reason to know. The proposed rule change defines a person with the “ability to influence the content of a research report” as an associated person who, in the ordinary course of that person’s duties, has the authority to review the research report and change that research report prior to publication or distribution.⁶⁷ FINRA understands that supervisors typically do not have the opportunity to review and insist on changes to public appearances, many of which are extemporaneous in nature. The proposal also retains the current requirement in NASD Rule 2711(h)(12) to maintain records of public appearances sufficient to demonstrate compliance by research analysts with the applicable disclosure requirements.⁶⁸

⁶⁶ See NASD Rules 2711(h)(1), (h)(2)(B) and (C), (h)(3) and (h)(9).

⁶⁷ See proposed FINRA Rule 2241.08.

⁶⁸ See proposed FINRA Rule 2241(d)(3).

Disclosure Required by Other Provisions

With respect to both research reports and public appearances, members and research analysts would continue to be required to comply with applicable disclosure provisions of FINRA Rule 2210, Incorporated NYSE Rule 472 and the federal securities laws.⁶⁹

Termination of Coverage

The proposal retains with non-substantive modifications the provision in the current rules that requires a member to notify its customers if it intends to terminate coverage of a subject company.⁷⁰ Such notification must be made promptly⁷¹ using the member's ordinary means to disseminate research reports on the subject company to its various customers. Unless impracticable, the notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a firm must disclose to its customers the reason for terminating coverage. FINRA expects such circumstances to be exceptional, such as where a research analyst covering a subject company or sector has left the member or the member has discontinued coverage of the industry or sector. FINRA believes this provision, which is consistent with the current rules, has been effective in achieving its

⁶⁹ See proposed FINRA Rule 2241(e). This is substantively the same as NASD Rule 2711(h)(9).

⁷⁰ See proposed FINRA Rule 2241(f).

⁷¹ While current Rule 2711(f)(6) does not contain the word "promptly," FINRA has interpreted the provision to require prompt notification of termination of coverage of a subject company.

original purpose to prevent firms from dropping coverage without notice or explanation instead of issuing a negative report on a current or prospective investment banking client.

Distribution of Member Research Reports

The proposal codifies an existing interpretation of FINRA Rule 2010 and provides additional guidance regarding selective – or tiered – dissemination of a firm’s research reports. In that regard, the proposal requires firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that the firm has previously determined are entitled to receive the research report.⁷² The proposal includes further guidance to explain that firms may provide different research products and services to different classes of customers, provided the products are not differentiated based on the timing of receipt of potentially market moving information and the firm discloses its research dissemination practices to all customers that receive a research product.⁷³

A member, for example, may offer one research product for those with a long-term investment horizon (“investor research”) and a different research product for those customers with a short-term investment horizon (“trading research”). These products may lead to different recommendations or ratings, provided that each is consistent with the meaning of the member’s ratings system for each respective product. Thus, for example, a firm may define a “buy” rating in investor research to mean that a stock will outperform the S&P 500 over the next 12 months. The same firm may define “sell” in

⁷² See proposed FINRA Rule 2241(g).

⁷³ See proposed FINRA Rule 2241.07.

trading research to mean a stock will underperform its sector index over the next month. The firm could maintain a “buy” in investor research at the same time it had a “sell” in trading research on the same stock if the firm believed, for example, that the company would report an earnings shortfall next week that would lead to a short-term drop in price relative to the sector index, but that the stock would recover to outperform the S&P 500 over the next 12 months. However, a member may not differentiate a research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member label a research product with substantially the same content as a different research product as a means to allow certain customers to trade in advance of other customers.

In addition, a member that provides different research products and services for certain customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research. FINRA understands, however, that customers may actually receive at different times research reports originally made available at the same time because of the mode of delivery elected by the customer eligible to receive such research services (e.g., in paper form versus electronic). However, members may not design or implement a distribution system intended to give a timing advantage to some customers over others. FINRA will read with interest comments as to whether a member should be required to disclose to its

other customers when an alternative research product or service does, in fact, contain a recommendation contrary to the research product or service that those customers receive.

Distribution of Third-Party Research Reports

The proposal expands upon the third-party research report distribution requirements in the current rules. The proposal generally maintains the existing third-party disclosure requirements,⁷⁴ with one modification. Consistent with the proposed disclosure requirement discussed above with respect to a member's own research reports, a distributing member would be required to disclose if the member or its affiliates maintain a significant financial interest in the debt or equity securities of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The proposed rule change also would require members to disclose any other material conflict of interest that can reasonably be expected to have influenced the member's choice of a third-party research provider or the subject company of a third-party research report.⁷⁵ FINRA believes that it is important that readers be made aware of any conflicts of interest present that may have influenced either the selection or content of research disseminated to

⁷⁴ NASD Rule 2711(h)(13)(A) currently requires the distributing member firm to disclose the following, if applicable: (1) if the member owns 1% or more of any class of equity securities of the subject company; (2) if the member or any affiliate has managed or co-managed a public offering of securities of the subject company or received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for such services in the next three months; (3) if the member makes a market in the subject company's securities; and (4) any other actual, material conflict of interest of the research analyst or member of which the research analyst knows or has reason to know at the time the research report is distributed or made available.

⁷⁵ See proposed FINRA Rule 2241(h)(4).

investors. As is the case in the existing Rules, the proposal requires that a member establish, maintain and enforce written policies and procedures reasonably designed to ensure the completeness and accuracy of all of the applicable disclosures to any third-party research it distributes.

In addition, the proposal continues to address qualitative aspects of third-party research reports. For example, the proposal maintains, but in the form of policies and procedures, the existing requirement that a registered principal or supervisory analyst review and approve third-party research reports distributed by a member. To that end, the proposed rule change requires a member to establish, maintain and enforce written policies and procedures reasonably designed to ensure that any third-party research it contains no untrue statement of material fact and is otherwise not false or misleading. For the purpose of this requirement, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading information that should be known from reading the research report or is known based on information otherwise possessed by the member.⁷⁶ The proposal further prohibits a member from distributing third-party research if it knows or has reason to know that such research is not objective or reliable.⁷⁷ FINRA believes that, where a member is distributing or "pushing-out" third-party research, the member must have policies and procedures to vet the quality of the research producers. A member would satisfy the standard based on its actual knowledge and reasonable diligence; however, there would

⁷⁶ See proposed FINRA Rules 2241(h)(1) and (h)(3).

⁷⁷ See proposed FINRA Rule 2241(h)(2).

be no duty of inquiry to definitively establish that the third-party research is, in fact, objective and reliable.

The proposal maintains the existing exceptions for “independent third-party research reports.” Specifically, such research does not require principal pre-approval or, where the third-party research is not “pushed out,” the third-party disclosures.⁷⁸ As to the latter, a member will not be considered to have distributed independent third-party research where the research is made available by the member: (a) upon request; (b) through a member-maintained website; or (c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

Finally, under the proposal, members also must ensure that a third-party research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the research report.⁷⁹ This requirement codifies guidance provided in Notice to Members 04-18.

Exemption for Firms with Limited Investment Banking Activity

The current rule exempts firms with limited investment banking activity – those that over the previous three years, on average per year, have managed or co-managed 10 or fewer investment banking transactions and generated \$5 million or less in gross revenues from those transactions – from the provisions that prohibit a research analyst from being subject to the supervision or control of an investment banking department

⁷⁸ See proposed FINRA Rule 2241(h)(5) and (6).

⁷⁹ See proposed FINRA Rule 2241(h)(7).

employee because the potential conflicts with investment banking are minimal.⁸⁰

However, those firms remain subject to the provision that requires the compensation of a research analyst to be reviewed and approved annually by a committee that reports to a member's board of directors, or a senior executive officer if the member has no board of directors.⁸¹ That provision further prohibits representation on the committee by investment banking department personnel and requires the committee to consider the following factors when reviewing a research analyst's compensation: (1) the research analyst's individual performance, including the research analyst's productivity and the quality of research; (2) the correlation between the research analyst's recommendations and the performance of the recommended securities; and (3) the overall ratings received from clients, the sales force and peers independent of investment banking, and other independent ratings services.⁸² Thus, the current exemption provides limited relief with respect to research analyst compensation determination, even where it is permissible for an investment banker to supervise and control a research analyst. FINRA believes it follows logically to allow those who supervise research analysts under such circumstances also to be involved in all aspects of the evaluation and determination of those analysts' compensation. Therefore, the proposed rule change extends the exemption for firms with limited investment banking activity so that such firms would not be subject to the compensation committee provision. FINRA notes that the proposal still prohibits these firms from compensating a research analyst based upon specific

⁸⁰ See NASD Rule 2711(k).

⁸¹ See NASD Rule 2711(d)(2).

⁸² See NASD Rule 2711(d) and (k).

investment banking services transactions or contributions to a member's investment banking services activities.⁸³

The proposed rule change further exempts firms with limited investment banking activity from the provisions restricting or limiting research coverage decisions and budget determination. While these two provisions are not in the current rules, as noted above, FINRA interprets NASD Rule 2711(b) to prohibit investment banking from making any final coverage decisions or determination of research budget. As such, the current exemption in NASD Rule 2711(k) effectively covers these two new provisions and so the proposal does not represent a substantive change. In addition, the proposal exempts eligible firms from the requirement to establish information barriers or other institutional safeguards to insulate research analysts from the review or oversight by investment banking personnel or other persons, including sales and trading personnel, who may be biased in their judgment or supervision. However, those firms still are required to establish, maintain and enforce written policies and procedures reasonably designed to ensure that research analysts are insulated from pressure by investment banking and other non-research personnel who might be biased in their judgment or supervision. FINRA believes that even where research analysts need not be structurally separated from investment banking or other non-research personnel, they should not be subject to pressures that could compromise their independence and objectivity.

FINRA reviewed and analyzed deal data for calendar years 2009 through 2011 to determine whether any adjustments should be made to these exemption standards. The review targeted firms that either managed or co-managed deals and earned underwriting

⁸³ See proposed FINRA Rules 2241(b)(2)(E) and (i).

revenues from those transactions during the review period. The analysis found that 155 of 317 such firms – or 49% – would have been eligible for the exemption. The data further suggested that incremental upward adjustments to the exemption thresholds would not result in a significant number of additional firms eligible for the exemption. For example, increasing both of the thresholds by 33% (to 40 transactions managed or co-managed and \$20 million in gross revenues over a three-year period) would result in 18 additional exempted firms. As such, FINRA believes the current exemption produces a reasonable and appropriate universe of exempted firms.

Exemption from Registration Requirements for Certain “Research Analysts”

As recommended in the Joint Report, the proposed rule change amends the definition of “research analyst” for the purposes of the registration and qualification requirements to limit the scope to persons who produce “research reports” and whose primary job function is to provide investment research (e.g. registered representatives or traders generally would not be included).⁸⁴ The revised definition is not intended to carve out anyone for whom the preparation of research is a significant component of their job; rather, it is intended to provide relief for those who produce research reports on an occasional basis. The existing research rules, in accordance with the Sarbanes-Oxley mandates, are constructed such that the author of a communication that meets the definition of a “research report” is a “research analyst,” irrespective of his or her title or primary job. FINRA believes that the registration and qualification requirements, which are not mandated by Sarbanes-Oxley, were intended for those individuals whose principal job function is to produce research, while the balance of the research rules are intended to

⁸⁴ See proposed NASD Rule 1050(b) and proposed Incorporated NYSE Rule 344.10.

foster objective analysis, transparency of certain conflicts and to provide beneficial information to investors. As such, the proposed exemption would extend only to the registration requirements, while all other obligations applicable to the production and distribution of research reports would remain.

Attestation Requirement

The proposal deletes the requirement to attest annually that the firm has in place written supervisory policies and procedures reasonably designed to achieve compliance with the applicable provisions of the rules, including the compensation committee review provision. FINRA notes that firms already are obligated pursuant to NASD Rule 3010 (Supervision) to have a supervisory system reasonably designed to achieve compliance with all applicable securities laws and regulations and FINRA rules. Moreover, the research rules also are subject to the supervisory control rules (NASD Rule 3012) and the annual certification requirement regarding compliance and supervisory processes (FINRA Rule 3130).⁸⁵ As such, FINRA believes a separate attestation requirement for the research rules is unnecessary.

Obligations of Persons Associated with a Member

Supplementary Material .09 clarifies the obligations of each associated person under those provisions of the proposed rule change that require a member to restrict or prohibit certain conduct by establishing, maintaining and enforcing particular written policies and procedures. Specifically, the rule provides that, consistent with FINRA Rule 0140, persons associated with a member must comply with such member's policies and

⁸⁵ NASD Rules 3010 and 3012 have been adopted with changes as consolidated FINRA rules. The new rules become effective December 1, 2014. See supra note 20.

procedures as established pursuant to proposed FINRA Rule 2241.⁸⁶ Failure of an associated person to comply with such policies and procedures shall constitute a violation of the rule itself. In addition, consistent with Rule 0140, the rule states that it shall be a rule violation for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by provisions of Rule 2241, including applicable Supplementary Material, that embed in the policies and procedures specific obligations on individuals. This Supplementary Material reflects FINRA's position that associated persons can be held liable for engaging in conduct that is proscribed by the member under FINRA rules. FINRA is clarifying this point in the Supplementary Material because the proposed rule change would adopt a policies and procedures approach to restricted and prohibited conduct with respect to research in place of specific proscriptions in the current rules.

Thus, for example, where the proposed rule requires a member to establish policies and procedures to prohibit research analyst participation in road shows, associated persons also are directly prohibited from engaging in such conduct, even where a member has failed to establish policies and procedures. FINRA believes that it is incumbent upon each associated person to familiarize themselves with the regulatory requirements applicable to his or her business and should not be able to avoid responsibility where minimum standards of conduct have been established for members.

General Exemptive Authority

⁸⁶ See proposed FINRA Rule 2241.09. FINRA Rule 0140(a), among other things, provides that persons associated with a member shall have the same duties and obligations as a member under the Rules.

The proposed rule change would provide FINRA, pursuant to the Rule 9600 Series, with authority to conditionally or unconditionally grant, in exceptional and unusual circumstances, an exemption from any requirement of the proposed rule for good cause shown, after taking into account all relevant factors and provided that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.⁸⁷ Given the scope of the rule's subject matter and the diversity of firm sizes, structures and research business and distribution models, FINRA believes it would be useful and appropriate to have the ability to provide relief from a particular provision of the proposed rules under specific factual circumstances.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸⁸ which requires, among other things, that FINRA 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. FINRA believes the proposed rule change protects investors and the public interest by maintaining, and in some cases expanding, structural safeguards to insulate research analysts from influences and pressures that could compromise the objectivity of

⁸⁷ See proposed FINRA Rule 2241(j).

⁸⁸ 15 U.S.C. 78o-3(b)(6).

research reports and public appearances on which investors rely to make investment decisions. FINRA further believes that the proposed rule change prevents fraudulent and manipulative acts and practices by requiring firms to identify and manage, often with extensive disclosure, conflicts of interest related to the preparation, content and distribution of research. At the same time, the proposal furthers the public interest by increasing information flow to investors in select circumstances – e.g., before and after the expiration of lock up provisions – where FINRA believes the integrity of research will not be compromised.

Moreover, the proposed rule change is consistent with Section 15D of the Act,⁸⁹ which requires rules reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public appearances. The proposed rule change requires firms to establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with the provisions of Section 15D, including: restricting prepublication clearance or approval of research reports by investment banking personnel or other persons not directly responsible for the preparation, content and distribution of research reports; prohibiting persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination; prohibiting retaliation or threat of retaliation against research analysts for research or public appearances that are unfavorable to the member's business interests; establishing quiet periods after public offerings during which members that have participated in the offering may not publish or otherwise distribute research; and

⁸⁹ 15 U.S.C. 78o-6.

establishing structural or institutional safeguards to protect analysts from the review, pressure or oversight of investment bankers or other non-research personnel that might be biased in their judgment or supervision. In addition, the proposed rule change requires disclosures consistent with Section 15D, including the requirement to disclose any material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of publication or distribution of a research report or during a public appearance.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change primarily reorganizes and restructures the current research rules, while maintaining the core provisions that have generally proven effective to promote objective and reliable research, as detailed through academic studies and other observations in the Joint Report and the GAO Report.⁹⁰ The GAO Report, for example, concluded that empirical results suggest the rules have resulted in increased analyst independence and weakened the influence of conflicts of interest on analyst recommendations.⁹¹ The proposed rule change also amends the current rules to ensure the objectives of independent research analysts and unbiased research are achieved in the most effective manner.

In some places, the proposed rule change reduces regulatory uncertainty around the applicability of current rules. For example, the new provision regarding distribution

⁹⁰ See Joint Report, supra note 6 at 16-26; see GAO Report, supra note 7 at 12-23.

⁹¹ See GAO Report, supra note 7 at 12-15.

of member research clarifies an existing interpretation prohibiting selective dissemination of research and provides guidance as to how members may differentiate research products to customers. In other places, the proposed rule change extends existing protections and adds new protections to fill gaps in the rules. Thus, the proposed rule change requires members to proactively identify and mitigate emerging conflicts related to the production and distribution of research, as members are best situated to spot such conflicts that may arise based on their particular business models or structures. As another example, the proposed rule change also extends the obligation to disclose material conflicts to associated persons with the ability to influence the content of a research report. This provision would close a gap that exists whereby persons who oversee research and research analysts could influence the recommendation or conclusions in a research report without disclosing their own material conflicts of interest or those of the member of which only they, and not the research analyst, know or have reason to know.

The new rules would impose burdens primarily arising from establishing, maintaining and enforcing new written policies and procedures to comply with the rule change, as well as a few new disclosures to customers to the extent a member's research activities require them. FINRA believes the additional burdens associated with these new provisions are minimal, but necessary to ensure the protections of the rules cannot be frustrated. At the same time, the proposed rule change provides increased flexibility for members to create compliance programs more closely tailored to their businesses and organizational structures, without diminishing investor protection. For example, as detailed in Item 3 of this filing, the proposed rule change replaces the many current

prescriptive requirements with respect to personal trading by research analyst accounts with a more flexible approach that requires policies and procedures to ensure that such accounts do not benefit in their trading from knowledge of the content and timing of research before the intended recipients have a reasonable opportunity to act on the information. FINRA believes this proposed change will maintain the current protection against a research analyst putting his or her own financial interests ahead of the analyst's customers' interest, but the increased flexibility will reduce costs and create fewer impediments to competition.

The proposed rule change also promotes capital formation and lessens compliance costs for firms by eliminating or reducing quiet periods during which research cannot be published or otherwise disseminated. FINRA further analyzed deal data to confirm that the parameters for the exemption for firms with limited investment banking activity remain appropriate and extended the exemption to include compensation determination provisions, thereby relieving eligible firms from an appreciable burden. The proposed rule change also lessens costs by creating a new limited exemption from the registration requirements for "research reports" produced by persons whose primary job function is something other than producing research and by eliminating the annual attestation requirement.

To help assess and minimize any burden on competition resulting from the proposal, FINRA consulted with several of its advisory committees and other industry members to solicit suggested changes to the existing rules and to obtain feedback on FINRA's proposed changes. Finally, as set forth in Item 5 of this filing, FINRA carefully

considered comments to an earlier version of the proposed rule change and made several changes in response to those comments.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FINRA solicited comments on an earlier iteration of the proposed rule change in Regulatory Notice 08-55 ("Notice Proposal"). The comment deadline expired on November 14, 2008. FINRA received five responses to the Notice Proposal.⁹²

Commenters expressed support for many aspects of the proposal, including reductions to the quiet period provisions, the exemption for members with limited investment banking activity and the more flexible supervisory approach with respect to research analyst account trading. SIFMA further expressed appreciation for the guidance with respect to selective dissemination of research products. Commenters nevertheless urged several modifications to the proposal, some of which have been incorporated into the proposed rule change. FINRA responds to the material comments to the Notice Proposal below.

Policies and Procedures

Both the Notice Proposal and the proposed rule change differ in several respects from current NASD Rule 2711, perhaps most notably in adopting a policies and procedures approach to identification and management of equity research-related

⁹² Letter from Daniel H. Kolber, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 10, 2008 ("Kolber"); letter from John I. Fitzgerald, Leerink Swann LLC, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 10, 2008 ("Leerink"); letter from Goodwin Procter LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 11, 2008 ("NVCA"); letter from Elliot R. Curzon, Dechert LLP, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 ("Dechert"); and letter from Amal Aly, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 ("SIFMA").

conflicts. FINRA has reintroduced several current provisions to the proposed rule change to clarify certain minimum standards and disclosure requirements. However, FINRA notes that the proposed rule change also establishes new standards of conduct. FINRA will provide guidance, where appropriate, as to the application of the new standards. FINRA cautions that members should not conclude that, where specific conduct prohibitions or disclosure requirements that exist in the current provisions have not been expressly included in the proposed rule change, such conduct is now permissible or such disclosures are no longer required. Firms must apply the new proposed standards to make those determinations. FINRA notes that some of the new standards are intended to require thoughtful compliance by members that may require them to adapt and change their policies and procedures as they gain experience and encounter new circumstances that may impact on the objectivity and reliability of research.

SIFMA endorsed the principle in the Notice Proposal and proposed rule change that members must implement policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts. Yet SIFMA found ambiguous and overbroad the companion principle that such policies and procedures should promote “reliable” research that reflects the “truly held opinions” of research analysts and prevent the use of research to “manipulate or condition the market” or “favor the interests of the member or certain current or prospective clients.” SIFMA asked FINRA to delete this introductory sentence and substitute the following alternative: “a member’s policies and procedures must be reasonably designed to promote independent and objective research that reflects the personal views of the analyst.”

Among other things, SIFMA asserted that the concept of “reliable” research is new and undefined.

FINRA believes that the term “reliable” is commonly understood. FINRA further believes that the other terms referenced above and cited by SIFMA as vague are similarly unambiguous in describing the conduct that a member’s policies and procedures must address or guard against. SIFMA made similar comments with respect to the words “reliable information” in the content and disclosure requirements of the Notice Proposal. As discussed below in response to that comment, that term is used in Sarbanes-Oxley without definition.

SIFMA requested that FINRA confirm that with respect to the proposed prohibitions on analyst compensation, consistent with current rules, the proposal would not prevent a member from compensating analysts for engaging in permissible vetting, commitment committee participation, due diligence, teach-ins, investor education, and other permissible banking-related activities. SIFMA also recommended that the proposal be amended so that compensation committees are required to consider the enumerated factors when reviewing a research analyst’s compensation only to the extent they are applicable. SIFMA suggested adding two new factors that are permissible for members to consider in determining analyst compensation, including the analyst’s seniority and experience, and the market for hiring and retention of analysts, noting that these factors are critical to the proper determination of analyst compensation and are specifically identified in the Global Settlement.

The proposal prohibits compensation based upon specific investment banking transactions or contributions to a member’s investment banking services activities. It

also requires the compensation review committee to consider the research analyst's productivity and quality of research. Both of these standards exist in the current rules. As SIFMA noted, FINRA staff previously stated that "screening potential investment banking clients is one of many factors to measure the quality of an analyst's research."⁹³ As such, FINRA concluded that the activity could be considered in determining a research analyst's compensation but "may not be given undue weight relative to evaluating the quality of other research work product." FINRA further cautioned, however, that "the size of any resultant or excluded investment banking deals should be irrelevant in assessing the quality of research."⁹⁴ The same guidance applies to the compensation provisions in the proposed rule change. FINRA considers commitment committee participation to be part of the vetting process and further views permissible due diligence and education of the sales force and investors as other legitimate factors to consider in measuring the productivity and quality of research, with the same caveats previously articulated regarding undue weight and the size of related investment banking services transactions. FINRA has amended the proposed rule text to clarify that the enumerated factors must be considered only to the extent applicable. The proposed rule change does not preclude consideration of additional factors, including the analyst's experience and market factors. The proposed rule change only sets out requirements and prohibitions with respect to compensation, and therefore FINRA has not included in the rule text the suggested permissible factors.

⁹³ See Letter from Philip A. Shaikun, Associate General Counsel, NASD, to James A. Brigagliano, Assistant Director, Division of Market Regulation, SEC, dated July 29, 2003, at page 8.

⁹⁴ Id.

SIFMA stated its support for “the general principle that members should implement policies and procedures reasonably designed to prevent market manipulation or front running of research.” However, SIFMA questioned the necessity of FINRA’s language in proposed Rule 2241(b)(2) that would require a firm’s policies and procedures to be reasonably designed to prevent the use of research reports or research analysts to “manipulate or condition the market or favor the interests of the member or certain current or prospective clients.” According to SIFMA, that principle is already codified in existing SEC anti-manipulation rules and FINRA’s front running prohibition in FINRA Rule 5270. Even if true, FINRA believes it is entirely appropriate to include that important principle as it relates to research reports and research analysts in a rule that is dedicated to research conflicts of interest and the conduct of research analysts. Moreover, FINRA notes that the proscribed conduct in its proposal is not congruent with either the SEC anti-manipulation or FINRA front running rules.

The Notice Proposal required members to “establish information barriers and other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight of persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision.” SIFMA suggested that members should be able to establish information barriers or other institutional safeguards to foster the required research analyst objectivity, since some information barriers are not always the most appropriate or efficient means to manage research conflicts. FINRA agrees and has amended the proposed rule change accordingly.

SIFMA further urged FINRA to replace the phrase “persons who might be biased in their judgment or supervision” with “persons within the firm who may try to improperly influence analysts’ views” because SIFMA contended that the former might sweep in salespeople, traders or subject companies that could have biases. FINRA notes that the proposed rule text came directly from the provisions of Sarbanes-Oxley related to management of research conflicts. FINRA believes that language is intended to apply only to persons within the firm and does not extend to subject companies, which have no oversight or supervisory role with respect to research analysts within a broker-dealer. Moreover, FINRA believes it’s appropriate for this conflict management provision to include salespeople or traders to the extent that a member employs such individuals in an oversight or supervisory capacity and has reason to know that some or all of those individuals might be biased in discharging those obligations. As such, FINRA has maintained the provision in the proposed rule change.

The Notice Proposal required members to prevent direct or indirect retaliation or threat of retaliation against research analysts by persons engaged in investment banking or other employees as the result of content of a research report. The proposed rule change maintains this requirement, but substitutes “prohibit” for “prevent” to align with the current rule language. SIFMA stated that the proposed provision is too broad because it applies to all employees, not just those involved in the investment banking department, and recommended that FINRA retain the current anti-retaliation provision in NASD Rule 2711(j). FINRA disagrees. As stated in the Joint Report, FINRA believes that under no circumstances is retaliation appropriate against a research analyst who expresses his or her truly held beliefs about a subject company. To the extent a person outside the

investment banking department is in a position to retaliate or threaten to retaliate against a research analyst – e.g., if the person is the chief executive officer, supervises the research analyst or is a member of the compensation review committee – FINRA believes the ban should cover them.

The Notice Proposal provided a more flexible supervisory approach with respect to trading by analyst accounts in securities of companies covered by the research analyst. SIFMA supported the proposed approach but asked FINRA to confirm that if members have adopted internal policies prohibiting analysts from owning securities issued by companies the analyst covers, members may permit an analyst to divest any such holdings pursuant to a reasonable plan of liquidation within 120 days of the effective date of the member's policy even if the sale is inconsistent with the analyst's current recommendation.

In response, FINRA has included in the proposed rule change Supplementary Material .10, which states that FINRA shall not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles that prohibit an analyst from benefitting from his or her personal trading based on the knowledge of the timing or content of a research report and that such plan is approved by the member's legal or compliance department.

The Notice Proposal required members to establish, maintain and enforce policies and procedures that prohibit participation by research analysts in "road shows and other

marketing on behalf of issuers.” SIFMA asked FINRA to clarify that the proscription does not apply to “investor education activities” and further is limited only to activities in connection with investment banking services transactions. By way of example, SIFMA suggested that the proposal would prohibit the practice by research analysts to facilitate meetings between investors and company management – so-called “non-deal road shows.” Leerink also questioned the scope of the provision and requested clarification with respect to whether the proposed language intends to eliminate the condition in Rule 2711 that the prohibition relate to the analyst’s participation in the marketing of a specific investment banking services transaction and, instead, would prohibit all participation in marketing by research analysts whether or not related to investment banking services. Leerink noted that not every contact with a company should be viewed as marketing the investment banking services of the analyst’s firm or jeopardizing the analyst’s objectivity. Leerink further noted that it would deprive analysts of important information necessary for their role if they are prohibited from contacts with an issuer in circumstances where the issuer may be marketing itself, including attendance by a research analyst at a research conference or investor forum. SIFMA also requested that FINRA confirm that consistent with existing guidance (NASD Notice to Members 07-04 and NYSE Information Memo 07-11) analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.

FINRA agrees that research analysts should be able to educate investors, provided such education occurs outside the presence of investment bankers and issuer management

and any such presentations are done in a fair and balanced manner. The proposed rule change therefore contains Supplementary Material .03 setting forth such permissible conduct, thus maintaining the current standard.

As discussed in the Purpose section, FINRA believes the primary role of research analysts is to function as unbiased intermediaries between issuers and the investors who buy the issuers' securities. FINRA believes marketing by research analysts on behalf of issuers is antithetical to promoting objective research on such issuers' securities. FINRA is primarily concerned with marketing by research analysts in connection with an investment banking services transaction, and therefore FINRA has added that clarification to the provision in the proposed rule change.

FINRA notes, however, that the overarching requirement to have policies and procedures to manage conflicts related to the interaction between research analysts and, among others, subject companies would apply to other marketing activity on behalf of an issuer. FINRA does not believe that merely facilitating a meeting between issuer management and investors, absent other facts, would constitute marketing on behalf of the issuer. Similarly, to Leerink's question, FINRA does not believe that mere attendance by a research analyst at a conference or forum where an issuer makes a presentation about its business prospects constitutes marketing "on behalf of an issuer." Nor would FINRA consider it marketing on behalf of an issuer for a member to sponsor such a conference or forum and permit its research analysts to attend or facilitate discussion. FINRA believes that there is a fundamental distinction between an issuer that markets itself and a research analyst who markets on behalf of the issuer. It is the latter

conduct that FINRA believes creates a conflict for a research analyst that must be prohibited or otherwise managed.

As noted in the Purpose section, the existing guidance in Notice to Members 07-04 would continue to apply to research analyst participation in road shows. Therefore, a research analyst would be able to listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.

Distribution of Member Research Reports

Leerink sought clarification regarding the scope of proposed Rule 2241(g) in the Notice Proposal, a codification of an interpretation to then NASD Rule 2110⁹⁵ that prohibits selective dissemination of a research report to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the report. Leerink questioned whether the proposed Supplementary Material regarding that provision would extend the prohibition beyond research reports to other services because it refers to “research products and services” and is not limited to “research reports.” Leerink requested clarification as to how FINRA would define “research products and services” and whether it would prohibit more generally favoring one type of client over another. The proposed Supplementary Material requires a member that provides different research products and services to different customers to notify the other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security.

⁹⁵ FINRA has since adopted NASD Rule 2110 as FINRA Rule 2010 without change. See Securities Exchange Act Release No. 58643 (September 25, 2008), 73 FR 57174 (October 1, 2008) (Order Approving File No. SR-FINRA-2008-028).

Leerink also asked whether there should be a carve out from the notification provision for institutional clients, and, if not, whether an oral notification would be sufficient, given the nature of firms' relationships with institutional clients.

FINRA first notes that Leerink mistakenly believed that FINRA was proposing to modify its prohibition regarding trading ahead of research reports found in then NASD IM-2110-4. In fact, that Interpretive Material referred to similar but distinct conduct regarding adjusting a member's inventory based upon non-public information regarding the timing or content of an impending research report. The Commission has since approved FINRA Rule 5280, which transferred NASD IM-2110-4 into the Consolidated FINRA Rulebook with changes.⁹⁶ The proposed rule change incorporates the aspect in FINRA Rule 5280 that the content of a research report may not be provided to internal trading personnel prior to public dissemination, but goes beyond that more narrow focus to address dissemination of a research report to one or more customers prior to other customers that the firm has previously determined are entitled to that report. The provision and accompanying Supplementary Material in the proposed rule change are limited by their terms to the dissemination of research products and services and do not address the broader question of when a member may not favor one client over another. FINRA included research "products and services" because FINRA understands that some customers receive not only different types of research reports than other customers, but also might receive other additional services related to research, such as more opportunity to interact directly with a research analyst. The Supplementary Material explains that offering those different services are permissible, provided they do not include differential

⁹⁶ See Securities Exchange Act Release No. 59254 (January 15, 2009), 74 FR 4271 (January 23, 2009) (Order Approving File No. SR-FINRA-2008-054).

timing in the receipt of potentially market moving information, including oral dissemination.

FINRA believes that the notification requirement in the Supplementary Material should apply to all customers that receive a research product or service from the member if the member provides different research products to different customers. FINRA notes that, consistent with Sarbanes-Oxley, the other provisions of the current and proposed rules do not differentiate between retail and institutional customers and further notes that not all institutional customers have the sophistication and experience to know without disclosure the nature and impact of differing research products and services. However, FINRA believes firms may put in place any reasonably designed notification process, provided they can evidence compliance with the requirement.

Quiet Periods

SIFMA, Leerink and NVCA generally supported the provisions in the Notice Proposal that would reduce the quiet period after IPOs for managers and co-managers from 40 days to 10 days, eliminate the quiet period after secondary offerings and eliminate the quiet periods around the waiver, expiration or termination of a lock-up agreement. These commenters believed that the Notice Proposal struck an appropriate balance between addressing conflicts and facilitating the flow of important information to investors. NVCA agreed with FINRA that other provisions of the Notice Proposal, together with SEC Regulation AC, would sufficiently maintain the integrity of research issued during what are now quiet periods.⁹⁷ The proposed rule change maintains these

⁹⁷ The remainder of the NVCA letter addressed more general matters concerning the strength and competitiveness of the U.S. IPO market that were not specifically directed at the FINRA proposal.

provisions, except that it imposes a minimum three-day quiet period after a secondary offering, unless an exception applies. FINRA made this change because SEC staff determined that Sarbanes-Oxley mandates a minimum quiet period for underwriters after a secondary offering. FINRA believes the proposed three-day period will fairly effectuate that mandate while minimizing the effect on information flow.

Content and Disclosure in Research Reports

With a couple of modifications, the Notice Proposal and the proposed rule change maintain the current content and disclosure requirements. The proposed rule change adds a requirement that a member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in its research reports are based on reliable information. The proposed rule change maintains the mandated Sarbanes-Oxley disclosure requirements,⁹⁸ as well as additional disclosure obligations – meanings and distribution of ratings and price charts, for example – that are designed to provide investors with useful information on which to base their investment decisions.

SIFMA was concerned by the use of the term “reliable” in the proposed provision that would require members to ensure that purported facts in their research reports are based on reliable information. As stated above, FINRA believes that term “reliable” is commonly understood. We note, for example, that the term “reliable information” is used in the research provisions of Sarbanes-Oxley without definition. Furthermore, SIFMA recommended the following as an alternative to the provision that members ensure that purported facts in research reports be based on reliable information: “policies and procedures reasonably designed to ensure that facts are based on ‘sources believed by

⁹⁸ See Section 501 Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

the member firm to be reliable.” (emphasis added). SIFMA appears to have borrowed the latter phrase from Exchange Act Rule 15c2-11(a), which also uses the term “reliable” without definition.

The Notice Proposal required a member to ensure that any recommendation, rating or price target have a “reasonable basis in fact” and be accompanied by a “clear explanation of the valuation method utilized and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.” SIFMA recommended two changes to this provision. First, SIFMA suggested that FINRA substitute the term “reasonable basis” rather than “reasonable basis in fact.” FINRA believes that even judgments and estimates on which recommendations, ratings and price targets are based must be grounded in certain facts, but we also believe that the term “reasonable basis” implies as much. Therefore, the proposed rule change maintains the “reasonable basis” standard in the current rule. SIFMA also noted that not all ratings are based on a valuation method, so FINRA has modified the language in the proposed rule change to that effect.

SIFMA also objected to the requirement in the proposal that a member must disclose in any research report “all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report.” SIFMA contended that the language would require members to identify “all possible conflicts (material or immaterial) that may be known to anyone at the member.” SIFMA recommended that FINRA revise the language to require only the enumerated disclosures, including the “catch-all” disclosure of “any other material conflict of interest

of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of the research report.” In addition, SIFMA urged FINRA to revise this provision so that it is consistent with current requirements because the mandate that the disclosures be made with respect to material conflicts of interest that are known not only at the time of publication, but also at the time of the distribution of a research report, is unworkable.

In general, FINRA believes that an immaterial conflict could not reasonably be expected to influence the objectivity of a research report, and therefore a materiality standard is essentially congruent with the proposed standard. FINRA agrees that the “catch-all” disclosure provision captures such material conflicts that the research analyst and persons with the ability to influence the content of a research report know or have reason to know. Therefore, FINRA has amended the proposal to delete as superfluous the overarching obligation to disclose “all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report.” FINRA notes that the term “distribution” is drawn from the provisions of Sarbanes-Oxley that apply to equity research reports and is intended to capture research that may only be distributed electronically as opposed to published in hard copy. However, FINRA interprets this language to require the disclosures to be current only as of the date of first publication or distribution, provided that the research report is prominently dated, and the disclosures are not known to be misleading.

SIFMA also labeled as unnecessary and burdensome the proposal's requirement to disclose if the member or its affiliates maintain a significant financial interest in the debt of a subject company. It asserted that such disclosure has little utility for investors, yet would require considerable resources to track such information. SIFMA also noted that to the extent that a member's ownership interest in a debt security presents a material conflict of interest, disclosure is already required by the "catch-all" provision that requires a member to disclose "any other material conflict of interest of the research analyst or member that the research analyst or a person associated with a member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report."

FINRA believes that a significant debt holding in the subject company could very well present a material conflict of interest that could inform an investor's decision making. For example, a negative equity research report that discusses a subject company's ability to meet its debt service or certain bond covenants could impact the value of high yield or other debt held by the member. FINRA also notes that the proposed disclosure is similar to that required by the United Kingdom's Financial Conduct Authority, whose rules many of SIFMA's members with global operations are already subject to. And while it is true that material conflicts can be captured by the "catch-all" provision, that should not preclude FINRA from delineating specific disclosures as it has with several other disclosures, including investment banking relationships.

SIFMA stated that it continues to believe that web-based disclosure promotes efficiency, provides important information to investors in a meaningful and effective

manner, and is consistent with important initiatives by the SEC to promote the use of electronic media, particularly with respect to price charts and ratings distribution tables, which are often cumbersome and difficult to produce in individual research reports. SIFMA contended that web-based disclosure would greatly ease production burdens and streamline the research reports themselves if they could be provided through websites. SIFMA also urged FINRA to consider permitting a web-based disclosure regime for public appearances because it would allow investors to consider and appreciate more fully the disclosures related to these activities. SIFMA states that web-based disclosures would allow investors to download, review, and assess the disclosures (as opposed to simply hearing them recited before or after an appearance, at which time investors may not focus on the substance of the disclosures). As stated in the Purpose section, FINRA was informed by SEC staff that it believes a web-based disclosure approach would not be consistent with Sarbanes-Oxley; therefore, FINRA has not proposed it here.

Third-Party Research

SIFMA noted that the Notice Proposal would impose a new requirement that members adopt policies and procedures to ensure that third-party research distributed by a member “is reliable and objective” in addition to the review standard in current Rule 2711(h) that would also be required by the Notice Proposal and proposed rule change. The current standard requires a members to review non-independent third-party research for any “untrue statement of material fact or any false or misleading information that: (i) should be known from reading the report; or (ii) is known based on information otherwise possessed by the member.” Independent third-party research is excepted from the review requirements. SIFMA asked FINRA to eliminate the new requirement or, at a minimum,

allow an exception for independent third-party research. Also, instead of requiring disclosure of the specific points of information delineated by the current rules, the Notice Proposal and the proposed rule change would include an overarching requirement that members disclose “any material conflict of interest that can reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third party research report.” SIFMA believed that the existing specific disclosure requirements struck the appropriate balance and urged FINRA to eliminate the proposed new requirement.

We do not think it unreasonable to require screening procedures for third-party research to help ensure, for example, that the third-party provider is not being paid by the issuer or that the research has some kind of track record or good reputation. In fact, in a 2006 comment letter, SIFMA stated that firms should “demand high standards” from providers of third-party research.⁹⁹ However, FINRA has amended the proposal to prohibit a member from distributing third-party research that it knows or has reason to know is not objective or reliable. FINRA believes this standard more appropriately requires reasonable diligence without a duty of inquiry to definitively ascertain whether the research is, in fact, objective and reliable. As for disclosures, FINRA has built back in to the proposed rule change the specific required third-party disclosures in the current rule, but we also think it reasonable to overlay a principle to require disclosure of any material conflict that may have influenced the choice of the third-party provider or subject company.

⁹⁹ See Letter from Michael D. Udoff, Vice President and Associate General Counsel, SIFMA, to Nancy M. Morris, Secretary, SEC, dated November 14, 2006.

Definitions

SIFMA and Dechert supported the provisions in the Notice Proposal to exclude from the definition of “research report” any communication on an open-end registered investment company that is not listed or traded on an exchange or a public direct participation program (“DPP”), but strongly urged FINRA to go further by carving-out written communications covering open-end exchange traded funds (“ETFs”) as well as private funds. These commenters argued that the same rationale that applies to the determination to exclude open-end investment companies also equally applies to ETFs and private funds (e.g., sales materials on ETFs and private funds are already subject to an extensive regulatory regime). Dechert stated that even though private fund sales literature is not subject to post-use review by FINRA, it does not need to be, because unlike open-end registered investment companies and public DPPs, it is only distributed to sophisticated investors. Dechert also believed that sales material on private funds are clearly prepared for marketing purposes and do not contain an analysis and, therefore, should not be subject to a regulatory regime that is intended to preserve the objectivity of analysis. Dechert further noted that sales literature cannot manipulate the price of a private fund because its value is calculated as the value of an open-end registered investment company using the NAV, not by the market. SIFMA also recommended that FINRA exclude from the definition of “research report” any type of periodic report or other communication for any managed client account, whether such account is “discretionary,” as the current rule provides, or non-discretionary in nature. SIFMA believed that the rationale for excluding discretionary accounts is equally applicable to non-discretionary accounts because clients who use these accounts, in general, rely on

their individual money managers, not research reports, to make investment decisions in line with their goals.

FINRA believes the carve-out should be limited to sales material related to mutual funds, which trade at NAV and are subject to the filing requirements of FINRA's advertising rules. ETFs, which are expanding in number and nature, are more susceptible to market-moving comments because they trade on an exchange and do not always trade at NAV, particularly if an ETF holds thinly traded securities or securities that are traded on a foreign exchange, or if an ETF is highly concentrated in a single or small number of securities.

For many of the same reasons, FINRA has reconsidered the proposed exemption for research on DPPs. FINRA has recently become more aware of research reports on master limited partnerships ("MLPs") that technically fall under the definition of a DPP due to questions that have arisen since FINRA's new Rule 2210 (Communications with the Public) became effective in February 2013. MLPs more closely resemble individual stocks since they do not invest in an underlying portfolio of securities and therefore do not have a NAV and, in fact, FINRA has observed that research on MLPs largely resembles research on any other exchange-traded stock. FINRA notes, however, that not every communication concerning a DPP will be a research report – only those that include an analysis of the equity securities of the issuer and information sufficient upon which to base an investment decision would meet the definition of a research report. Sales material on private funds is not subject to FINRA's advertising review filing requirements. To the extent that the sales material does not, as Dechert asserts, contain an analysis, then it would not meet the definition of a research report. FINRA further

notes that the rules do not currently except research on private securities nor is there an institutional carve-out, so to except research on hedge funds, for example, might set up an inconsistency.

SIFMA stated that the proposed revisions to the definition of “investment banking services” are overly broad and that FINRA should retain the current definition for this term. SIFMA expressed concern that the added language would broaden the definition to include personnel and departments not traditionally viewed as related to investment banking, including sales activities. As noted in the Purpose section, the current definition includes, without limitation, many common types of investment banking services. FINRA added the language “or otherwise acting in furtherance of” in the proposed rule change to further emphasize that the term should be broadly construed to cover all aspects of facilitating a public or private offering, as well as other investment banking activities. However, the new language is not intended to capture sales activities.

Pitch Book Materials

The proposed rule change requires policies and procedures reasonably designed to prohibit research analyst participation in pitches and other solicitation of investment banking services transactions. Supplementary Material .01 codifies previous guidance in Notice to Members 07-04, which sets out the principle that pitch materials may not contain any information about a member’s research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage. The supplementary material specifies that members may include the fact of coverage and the name of the research analyst because such information alone does not imply favorable coverage. The supplementary material also states FINRA’s view that including an

analyst's industry ranking in pitch materials implies favorable research because of the manner in which such rankings are compiled; i.e., they are voted on by institutional investors that tend to benefit from positive coverage of their holdings. SIFMA requested that FINRA revise the example provided in the proposed supplementary material to clarify what sort of materials are prohibited or provide an alternative example of prohibited pitch materials. SIFMA also asked that FINRA confirm that members may disclose in pitch materials the fact that research coverage will be provided for a particular issuer.

FINRA believes the principle is clear and has included examples to illustrate FINRA's view of its application. Whether other information included in pitch materials violate the principle will depend on the facts and circumstances.

Effective Date

SIFMA requested that FINRA provide a 120-day grace period between the adoption of the proposal and the implementation of the proposed rules because some of the proposals will require major systems changes to firms' information technology systems, research report templates, and policies and procedures. FINRA is sensitive to the time firms will require to update their policies and procedures and systems to comply with the proposed rule change and will take those factors into consideration when establishing an implementation date.

Other Comments

Kolber supported the proposed change to exempt from FINRA's research analyst registration and qualification requirements those individuals who produce "research reports" but whose primary job function is something other than to provide investment

research. The remainder of Kolber's comments with respect to the research registration and qualification requirements addressed more generally the scope and difficulty of the Series 86 examination, which is not the subject of the proposal. Kolber also stated that the definition of "research report" can be difficult to apply because it sets forth a standard and then lists several exceptions from the definition. FINRA notes that the structure is very similar to the definition of research report in Regulation AC and is not an uncommon drafting method. Kolber's other comments are directed to the difficulty of distinguishing between the definitions of "sales literature" and "advertisement" in former NASD Rule 2210. That rule has since been replaced by consolidated FINRA Rule 2210, where those definitions no longer exist.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2014-047 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2014-047. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All

submissions should refer to File Number SR-FINRA-2014-047 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁰⁰

Brent J. Fields
Secretary

¹⁰⁰ 17 CFR 200.30-3(a)(12).

Regulatory Notice

08-55

Research Analysts and Research Reports

FINRA Requests Comment on Proposed Research Registration and Conflict of Interest Rules

Comment Period Expires: November 14, 2008

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on proposed research analyst conflict of interest rules.

The text of proposed FINRA Rules 1223 and 2240 is set forth in Attachment A.

Questions regarding this *Notice* should be directed to Philip Shaikun, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8451.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by November 14, 2008.

Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:
 Marcia E. Asquith
 Office of the Corporate Secretary
 FINRA
 1735 K Street, NW
 Washington, DC 20006-1506

October 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Registration
- Research
- Senior Management

Key Topic(s)

- Registration
- Research Analysts
- Research Reports
- Supervision

Referenced Rules & Notices

- NASD Rule 1050
- NASD Rule 2210
- NASD Rule 2711
- NYSE Rule 344
- NYSE Rule 342
- NYSE Rule 472

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this Notice will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Background

NASD Rule 2711 (Research Analysts and Research Reports) and Incorporated NYSE Rule 472 (Communications with the Public) (the Rules) set forth requirements to foster objectivity and transparency in equity research and provide investors with more reliable and useful information to make investment decisions. The Rules were intended to restore public confidence in the validity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities. The trustworthiness of research had eroded due to the pervasive influences of investment banking and other conflicts that became apparent during the market boom of the late 1990s.

The current NASD and Incorporated NYSE Rules have no significant differences. Generally, the Rules require clear, comprehensive and prominent disclosure of conflicts of interest in research reports and public appearances by research analysts. The Rules further prohibit certain conduct – investment banking personnel involvement in the content of research and determination of analyst compensation, for example – when the conflicts are considered too pronounced to be cured by disclosure. Several of the Rules' provisions implement the mandates of the Sarbanes-Oxley Act of 2002 (SOx), which proscribes certain conduct and requires some specific disclosures in research reports and public appearances.

NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) require any person associated with a member firm and who functions as a research analyst to be registered as such and pass the Series 86 and 87 exams, unless an exemption applies. A research analyst is defined for the purposes of those rules as “an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.”

In December 2005, in response to a Securities and Exchange Commission (SEC or Commission) Order, FINRA and the NYSE submitted to the SEC a joint report on the operation and effectiveness of the research analyst conflict of interest rules. The report concluded that the Rules have been effective in helping to restore integrity to research by minimizing the influences of investment banking and promoting transparency of other potential conflicts of interest. Evidence suggested that investors are benefiting from more balanced and accurate research to aid their investment decisions. The report also recommended certain changes to the Rules to strike an even better balance between ensuring objective and reliable research on the one hand, and permitting the flow of information to investors and minimizing costs and burdens to member firms on the other. Many of those recommendations are the subject of a FINRA rule filing pending before the SEC (Joint Report Filing) that would be superseded by the proposal in this *Notice*.

Proposal

FINRA proposes replacing the existing Rules with a single rule in the Consolidated FINRA Rulebook and rewriting the research rules in a more streamlined and flexible fashion within the confines set forth in SOx. Within this structure, the new rule would broaden the obligations on member firms to identify and manage research conflicts. It also would incorporate several aspects of the Joint Report Filing and resolve the few differences between that filing and a substantially similar one filed with the SEC by NYSE to amend its Rule 472. Among other things, the proposal additionally codifies an existing interpretation regarding selective dissemination of research and provides further guidance on the subject. The proposal also extends the exemption for firms with limited investment banking activity to include certain aspects related to research analyst compensation determination.

The most significant proposed changes are described generally below. However, FINRA urges member firms to carefully review the entire attached proposed rule text to understand the full extent of the proposed changes. FINRA notes that the proposal renumbers the new rules as FINRA Rules 1223 and 2240. It also reorganizes new Rule 2240 and includes a "Supplementary Material" section that contains some existing rule language and guidance.

Definitions

FINRA proposes to maintain the definitions in the existing Rules, with a few modifications. The proposal:

- makes minor changes to the definition of “investment banking services” to clarify that such services include all acts in furtherance of a public or private offering on behalf of an issuer.
- incorporates a proposed change from the Joint Report Filing to the definition of “research analyst account” to clarify that the definition does not apply to a registered investment company over which a research analyst has discretion or control, provided that the research analyst or a member of that research analyst’s household has no financial interest in the investment company, other than a performance or management fee.
- incorporates the Joint Report Filing proposed change to the definition of “research report” to exclude sales material regarding open-end registered investment companies that are not listed or traded on an exchange and public direct participation programs.
- moves into this section the definitions of “third-party research report” and “independent third-party research report” that are now in a separate provision of the Rules.

Identifying and Managing Conflicts of Interest

The proposal creates a new section entitled “Identifying and Managing Conflicts of Interest.” The section includes an overarching provision that requires member firms to establish, maintain and enforce policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts. A second provision sets forth more specifically what those policies and procedures must address. They must promote objective and reliable research that reflects the truly held opinions of research analysts and prevent the use of research or research analysts to manipulate or condition the market or favor the interests of the member firm or certain current or prospective clients.

SOx requires rules to prohibit or restrict certain conduct related to the preparation, approval and distribution of research reports and the determination of research analysts’ compensation. The proposal therefore requires at a minimum that the above-referenced policies and procedures be reasonably designed to achieve compliance with the SOx conduct and structural mandates. However, in contrast to the more prescriptive manner in which the current Rules implement the SOx requirements, the proposal provides firms with more flexibility to adopt policies and procedures to effectuate those mandates in a manner consistent with the member firm’s size and organizational structure.

Thus, the proposal requires firms to establish, maintain and enforce policies and procedures that at a minimum:

- prohibit prepublication review, clearance and approval of research reports by persons engaged in investment banking activities and prohibit or restrict such review, clearance and approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel;
- limit the supervision and compensatory evaluation of research analysts to persons who are not engaged in investment banking services transactions;
- establish information barriers and other safeguards to insulate research analysts from pressure by investment banking personnel and other persons who might be biased in their judgment or supervision;
- prevent direct or indirect retaliation against research analysts as a result of content of a research report that may adversely affect a current or prospective client relationship; and
- define quiet periods of at least 10 days after an initial public offering (IPO) during which a member firm must not publish or otherwise distribute research reports, and research analysts must not make public appearances relating to the issuer if the firm has participated as an underwriter or dealer in the offering.⁴

The proposal retains the current requirement that a committee that reports to the member firm's board of directors – or if none exists, a senior executive officer – review and approve the compensation of any research analyst who is primarily responsible for preparation of the substance of a research report. This committee may not have representation from a member firm's investment banking department and may not consider contributions to a member firm's investment banking business in assessing a research analyst's compensation. The committee must consider, among other things, the productivity of the research analyst and the quality and accuracy of his or her research and must document the basis for each research analyst's compensation.

With respect to the quiet-period provision, FINRA notes that the proposal differs from the Joint Report Filing, which proposed a 25-day IPO quiet period for all underwriters and dealers. However, like the Joint Report Filing, the proposal eliminates the 10-day quiet period after secondary offerings. The proposal also eliminates the current quiet periods 15 days before and after the expiration, waiver or termination of a lock-up agreement. FINRA believes that research issued during such periods potentially offers valuable market information, and the other provisions of the research rules and SEC Regulation AC provide sufficient protection that such research will honestly reflect the analyst's beliefs and be free from other conflicts that would undermine the value or integrity of research issued during these periods.⁵

Additionally, the proposal requires firms to adopt policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting participation in the solicitation of investment banking business, road shows and other marketing on behalf of an issuer. This standard largely maintains the existing proscriptions regarding research analyst conduct. The proposal also maintains the current prohibition against promises of particular research or a recommendation or rating as inducement for receipt of business or compensation and prohibits prepublication review by a subject company for purposes other than verification of facts.

Personal Trading Restrictions

The proposal creates a more flexible supervisory approach with respect to research analyst account trading in securities of companies a research analyst covers. The current Rules prohibit ownership of pre-IPO shares in a research analyst's coverage area; impose specific blackout periods during which a research analyst account may not trade covered securities; prohibit trading against recommendation; and require pre-approval by legal and compliance of transactions in covered securities by persons who oversee research analysts. The current Rules carve out specific investments from the trading restrictions and also set forth particular exceptions to the provisions with approval of legal and compliance.

The proposal instead requires firms to establish policies and procedures that restrict or limit research analyst account trading in securities a research analyst covers, any derivatives of such securities and funds whose performance is materially dependent upon the performance of such securities. Such policies and procedures must ensure that research analysts and others with the ability to influence the content of research reports don't benefit in their trading from the knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report. Firms further are required to define financial hardship circumstances, if any, in which a firm would permit a research analyst to trade against his or her recommendation.

Content and Disclosure in Research Reports

With a couple of modifications and exceptions, the proposal mostly maintains the content and disclosure requirements of the current Rules. This is due in large part to SOx, which mandates disclosure in research reports and public appearances of a research analyst's financial interest in a subject company; whether the research analyst or the member firm or its affiliates has received any compensation from the subject company; whether the issuer has been a client of the member firm within a year of the date of publication of the research report or public appearance and the types of services provided to the issuer; whether the research analyst received compensation with respect to a research report based upon the investment banking revenues of the firm; and other material conflicts.

Certain provisions – the distribution of ratings and price chart requirements, for example – have been maintained because FINRA believes they provide valuable information to investors to assess the objectivity of a research report and the accuracy of a research analyst's past recommendations, ratings or price targets.

The proposal requires a member firm to ensure that purported facts in its research reports are based on reliable information. Otherwise, the proposal adopts, with some language modifications, the existing content requirements:

- Any recommendation, rating or price target must have a reasonable basis in fact and be accompanied by a clear explanation of the valuation method utilized and a fair presentation of risks that may impede its achievement.
- Ratings must be clearly defined in each research report and include any time horizon or benchmark on which the rating is based.
- Irrespective of the rating system employed, a member firm must include in each research report that includes a recommendation or rating the percentage of all securities rated by the member firm to which the member firm assigns a “buy”, “hold” or “sell” rating.
- A member firm must disclose in each research report the percentage of subject companies within each of the “buy,” “hold” and “sell” categories for which the firm provided investment banking services within the previous twelve months.
- If a research report contains a rating or price target, the member firm must include a price chart that shows the stock price movement of the subject company's security in relation to the dates on which the firm assigned or changed a rating or price target.

With respect to disclosure of potential conflicts, the proposal requires a member firm to disclose in any research report all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member firm or research analyst on the date of distribution. The proposal includes among such conflicts most of those that must be disclosed under the current Rules, including those related to receipt of investment banking and non-investment banking compensation and market making.

The proposal modifies the requirement to disclose when a member firm or its affiliates owns securities of the subject company. The proposal requires disclosure if a member firm or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member firm or its affiliates beneficially own 1 percent or more of any class of common equity securities of the subject company. The determination of beneficial ownership continues to be based upon the standards used to compute ownership for the purposes of the reporting requirements under Section 13(d) of the Exchange Act.

The proposal retains the general exception to the disclosure requirements in circumstances where disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company. The proposal also continues to permit a member firm that distributes a research report covering six or more companies (compendium report) to direct the reader in a clear manner as to where the applicable disclosures can be found. While an electronic compendium research report may hyperlink to the disclosures – as is the case for any electronic research report – a paper-based compendium report must include a toll-free number or a postal address where the reader may obtain the disclosures. Paper research reports may additionally include a Web address where the disclosures can be found.

FINRA notes that except for electronic research reports, the proposal does not permit Web-based disclosure. The Joint Report Filing proposed such disclosure, but the SEC staff informed FINRA that it interprets SOx to require disclosures in the research report itself, except as noted above. The SEC staff further indicated that it did not intend to use its exemptive authority under the Exchange Act to allow such Web-based disclosure. FINRA continues to advocate Web-based disclosure as more efficient and effective and will consider amending the proposal should the SEC staff change its position.

Public Appearances

The proposal groups in a separate provision the disclosures required when a research analyst makes a public appearance. The required disclosures effectively remain the same as under the current Rules, with one exception: consistent with the above-referenced provision with respect to disclosure in research reports, a research analyst would be required to disclose if a member firm or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member firm or its affiliates beneficially own 1 percent or more of any class of common equity securities of the subject company, as computed in accordance with Section 13(d) of the Exchange Act. The proposal also adopts the requirement under NASD Rule 2711 to maintain records of public appearances sufficient to demonstrate compliance by research analysts with the applicable disclosure requirements. The more prescriptive recordkeeping requirements of Incorporated NYSE Rule 472 would be deleted under the proposal.

Disclosure Required by Other Provisions

With respect to both research reports and public appearances, member firms and research analysts would continue to be required to comply with applicable disclosure provisions of NASD Rule 2210, Incorporated NYSE Rule 472 and the federal securities laws.

Termination of Coverage

The proposal retains in its entirety the provision in the current Rules that requires a member firm to promptly notify its customers if it intends to terminate coverage of a subject company. Such notification must be made using the means of dissemination equivalent to those a member firm ordinarily uses to distribute research reports to its various customers. If practicable, the notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a firm must disclose to its customers the reason for terminating coverage.

Distribution of Member Firms' Research Reports

The proposal codifies an existing interpretation of NASD Rule 2110 and provides additional guidance regarding selective – or tiered – dissemination of a firm's research reports. In that regard, the proposal requires firms to establish policies and procedures to ensure that a research report is not distributed to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the research report. The proposal includes further guidance to explain that firms may provide different research products and services to certain classes of customers, provided the firm discloses its research dissemination practices to all customers. A member firm may, by way of example, differentiate its research product offerings based on the recommendations provided to its trading versus its investing clients, the depth of research content (but not the ultimate recommendation) provided to certain classes of customer as determined by the member or whether such different classes of customers will receive certain research services at all. A firm may not, however, differentiate the timing of the availability of research to any customer within the class of customers eligible to receive a particular research report or product. FINRA understands, however, that customers may actually receive at different times research reports originally made available at the same time because of the mode of delivery elected by the customer eligible to receive such research services (*e.g.* in paper form versus electronic). However, member firms may not “game” the mode of delivery in order to preference certain customers over others in the timing of receipt of reports.

Distribution of Third-Party Research Reports

The proposal incorporates in their entirety the current provisions regarding distribution and supervision of third-party research. A detailed discussion of those provisions can be found in *Regulatory Notice 08-16*.

Exemption for Firms with Limited Investment Banking Activity

The proposal extends the exemption for firms with limited investment banking activity to include the provision that prohibits investment banking personnel involvement in determining a research analyst's compensation and the requirement that a committee review and approve such compensation.

The current rule exempts such firms – those that over the previous three years, on average per year, have managed or co-managed 10 or fewer investment banking transactions and generated \$5 million or less in gross revenues from those transactions – from the provisions that prohibit a research analyst from being subject to the supervision or control of an investment banking department employee because the potential conflicts with investment banking are minimal. FINRA believes it follows logically to allow those who supervise research analysts under such circumstances also to be involved in the determination of those analysts' compensation. The proposal still prohibits these firms from compensating a research analyst based upon specific investment banking services transactions or contributions to a member firm's investment banking services activities.

Exemption from Registration Requirements for Certain “Research Analysts”

As in the Joint Report Filing, the proposal exempts from the registration and qualification requirements personnel who produce “research reports” but whose primary job is something other than a research analyst (*e.g.* a registered representative or trader). The existing research rules, in accordance with the SOx mandates, are constructed such that the author of a communication that meets the definition of a “research report” is a “research analyst,” irrespective of his or her title or primary job. FINRA believes that the registration and qualification requirements were intended for those individuals whose principal job function is to produce research, while the balance of the research rules are intended to foster objective analysis, transparency of certain conflicts and to provide beneficial information to investors. As such, the proposed exemption extends only to the registration requirements.

Attestation Requirement

The proposal deletes the requirement to attest annually that the firm has in place supervisory policies and procedures reasonably designed to achieve compliance with the applicable provisions of the rules, including the compensation committee review provision. FINRA notes that firms would remain obligated pursuant to have a supervisory system reasonably designed to achieve compliance with all applicable securities laws and regulations.

Endnotes

- 1 The current FINRA rulebook includes (1) NASD Rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). For more information about the rulebook consolidation process, see *Information Notice 03/12/08 (Rulebook Consolidation Process)*.
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 4 Firms still would be required to comply with any additional quiet periods that the federal securities laws impose.
- 5 The proposal does not incorporate an element of the Joint Report Filing that would have required an additional attestation that a member has a bona fide reason for issuing research during those 15-day periods before and after the expiration, waiver or termination of a lock-up agreement.

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Attachment A

Below is the text of Proposed FINRA Rules 1223 and 2240. With respect to Proposed FINRA Rule 1223, new language is underlined; proposed deletions are in brackets.

* * * * *

[1050.] FINRA Rule 1223. Registration of Research Analysts¹

(a) All persons associated with a member who are to function as research analysts shall be registered with [NASD]FINRA. Before registration as a Research Analyst can become effective, an applicant shall:

(1) be registered pursuant to NASD Rule 1032 as a General Securities Representative; and

(2) pass a Qualification Examination for Research Analysts as specified by the Board of Governors.

(b) For the purposes of this Rule 1223[1050], “research analyst” shall mean an associated person whose primary job function is to provide investment research and who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.

(c) Upon written request pursuant to the Rule 9600 Series, [NASD]FINRA will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has [passed]:

(1) passed Levels I and II of the Chartered Financial Analyst (“CFA”) Examination; or

(2) [if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e),] passed Levels I and II of the Chartered Market Technician (“CMT”) Examination, if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e); and

(3) [has] either functioned as a research analyst continuously since having passed the Level II CFA or CMT examination or applied for registration as a research analyst within two years of having passed the Level II CFA or CMT examination.

¹ The draft text is marked to show changes between NASD Rule 1050 and proposed FINRA Rule 1223. The proposal would delete the corresponding provisions in Incorporated NYSE Rule 344 and Rule Interpretation 344.

(d) An applicant who has been granted an exemption pursuant to paragraph (c) still must become registered as a General Securities Representative and then complete the regulatory portion of the Research Analyst Qualification Examination (Series 87) before that applicant can be registered as a Research Analyst.

(e) For the purposes of paragraph (c)(2), a “technical research report” shall mean a research report, as that term is defined in Rule [2711]2240(a)([8]10), that is based solely on stock price movement and trading volume and not on [the]a subject company’s financial information, business prospects, contact with a subject company’s management, or the valuation of a subject company’s securities.

(f) The requirements of paragraph (a) shall not apply to an associated person who:

(1) is an employee of a non-member foreign affiliate of a member (“foreign research analyst”),

(2) resides outside the United States, and

(3) contributes, partially or entirely, to the preparation of globally[-] branded or foreign affiliate research reports but does not contribute to the preparation of a member’s research, including a mixed-team report, that is not globally[-]branded.

Provided that the following conditions are satisfied:

(A) A member that publishes or otherwise distributes globally[-] branded research reports partially or entirely prepared by a foreign research analyst must subject such research to pre-use review and approval by a registered principal in accordance with NASD Rule 1022(a)(5) or a supervisory analyst pursuant to NYSE Rule 344.11. In addition, the member must ensure that such research reports comply with [NASD]Rule [2711]2240, as applicable.

(B) In publishing or otherwise distributing globally[-]branded research reports partially or entirely prepared by a foreign research analyst, a member must prominently disclose:

(i) each affiliate contributing to the research report;

(ii) the names of the foreign research analysts employed by each contributing affiliate;

(iii) that such research analysts are not registered/qualified as research analysts with FINRA[with the NYSE and/or NASD]; and

(iv) that such research analysts may not be associated persons of the member and therefore may not be subject to Rule [2711]2240 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(C) The disclosures required by paragraph (f)(3)(B) of this Rule must be presented on the front page of the research report or the front page must refer to the page on which the disclosures can be found. In electronic research reports, a member may hyperlink to the disclosures. References and disclosures must be clear, comprehensive and prominent.

(D) Members must establish and maintain records that identify those individuals who have availed themselves of this exemption, the basis for such exemption, and evidence of compliance with the conditions of the exemption. Failure to establish and maintain such records shall create an inference of a violation of Rule 1223[1050]. Members must also establish and maintain records that evidence compliance with the applicable content, disclosure and supervision provisions of Rule 2240[2711]. Members must maintain these records in accordance with the supervisory requirements of Rule 3010, and in addition to such requirement, the failure to establish and maintain such records shall create an inference of a violation of the applicable content, disclosure and supervision provisions of Rule 2240[2711].

(E) Nothing in paragraph (f) of this Rule shall affect the obligation of any person or broker-dealer, including a foreign broker-dealer, to comply with the applicable provisions of the federal securities laws, rules and regulations and any self-regulatory organization rules.

(F) The fact that a foreign research analyst avails himself of the exemption in paragraph (f) shall not be probative of whether that individual is an associated person of the member for other purposes, including whether the foreign research analyst is subject to the Rule 2240[2711] restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(G) A member that distributes non-member foreign affiliate research reports that are clearly and prominently labeled as such must comply with the third-party research report requirements in Rule [2711]2240(h)[(13)].

(H) For the purposes of the exemption in paragraph (f), the terms “affiliate,” “globally.[-]branded research report” and “mixed-team research report” shall have the following meanings:

(i) “Affiliate” shall mean a person that directly or indirectly controls, is controlled by, or is under common control with, a member.

(ii) “Globally.[-]branded research report” refers to the use of a single marketing identity that encompasses the member and one or more of its affiliates.

(iii) “Mixed-team research report” refers to any member research report that is not globally.[-]branded and includes a contribution by a research analyst who is not an associated person of the member.

FINRA Rule 2240. Research Analysts and Research Reports²**(a) Definitions**

For purposes of this Rule, the following terms shall be defined as provided.

(1) “Equity security” has the same meaning as defined in Section 3(a)(11) of the Exchange Act.

(2) “Independent third-party research report” means a third-party research report, in respect of which the person producing the report:

(A) has no affiliation or business or contractual relationship with the distributing member or that member’s affiliates that is reasonably likely to inform the content of its research reports; and

(B) makes content determinations without any input from the distributing member or that member’s affiliates.

(3) “Investment banking department” means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(4) “Investment banking services” include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

(5) “Member of a research analyst’s household” means any individual whose principal residence is the same as the research analyst’s principal residence. This term 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.

² The proposal would delete NASD Rule 2711 and the corresponding provisions of Incorporated NYSE Rules 351, 472 and Rule Interpretation 472.

(6) “Public appearance” means any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons or before one or more representatives of the media, a radio, television or print media interview, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security. This term does not include a password protected Webcast, conference call or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading or no longer applicable.

(7) “Research analyst” means an associated person who is primarily responsible for, and any associated person who reports directly or indirectly to a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of “research analyst.”

(8) “Research analyst account” means any account in which a research analyst or member of the research analyst’s household has a financial interest, or over which such analyst has discretion or control. This term shall not include an investment company registered under the Investment Company Act of 1940 over which the research analyst or a member of the research analyst’s household has discretion or control, provided that the research analyst or member of a research analyst’s household has no financial interest in such investment company, other than a performance or management fee. The term also shall not include a “blind trust” account that is controlled by a person other than the research analyst or member of the research analyst’s household where neither the research analyst nor a member of the research analyst’s household knows of the account’s investments or investment transactions.

(9) “Research department” means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(10) “Research report” means any written (including electronic) communication that includes an analysis of equity securities of individual companies or industries (other than an open-end registered investment company that is not listed or traded on an exchange or a public direct participation program) and that provides information reasonably sufficient upon which to base an investment decision. This term does not include:

(A) communications that are limited to the following:

- (i) discussions of broad-based indices;
- (ii) commentaries on economic, political or market conditions;
- (iii) technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price;
- (iv) statistical summaries of multiple companies’ financial data, including listings of current ratings;
- (v) recommendations regarding increasing or decreasing holdings in particular industries or sectors; or
- (vi) notices of ratings or price target changes, provided that the member 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 this Rule and that such research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable;

(B) the following communications, even if they include an analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision:

- (i) any communication distributed to fewer than 15 persons;
- (ii) 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 account’s past performance or the basis for previously made discretionary investment decisions; or
- (iii) internal communications that are not given to current or prospective customers; and

(C) communications that constitute statutory prospectuses that are filed as part of a registration statement.

(11) “Subject company” means the company whose equity securities are the subject of a research report or a public appearance.

(12) “Third-party research report” means a research report that is produced by a person or entity other than the member.

(b) Identifying and Managing Conflicts of Interest

(1) A member must establish, maintain and enforce policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to:

(A) the preparation, content and distribution of research reports; and

(B) public appearances by research analysts.

(2) A member’s policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member or certain current or prospective clients. Such policies and procedures must at a minimum:

(A) prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel;

(B) limit supervision and determination of compensation of research analysts to persons not engaged in investment banking services activities;

(C) prohibit compensation based upon specific investment banking services transactions or contributions to a member’s investment banking services activities;

(D) require that the compensation of a research analyst who is primarily responsible for the substance of a research report be reviewed and approved at least annually by a committee that reports to a member's board of directors, or if the member has no board of directors, a senior executive officer of the member. This committee may not have representation from the member's investment banking department and must consider the following factors when reviewing a research analyst's compensation:

- (i) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;
- (ii) the correlation between the research analyst's recommendations and the stock price performance; and
- (iii) the overall ratings received from clients, sales force and peers independent of the member's investment banking department, and other independent ratings services.

The committee must document the basis upon which each such research analyst's compensation was established.

(E) establish information barriers and other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision;

(F) prevent direct or indirect retaliation or threat of retaliation against research analysts by persons engaged in investment banking services activities or other employees as the result of content of a research report;

(G) define periods of a minimum of 10 days after the completion of an initial public offering during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer if the member has participated as an underwriter or dealer in the offering;

(H) restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst, including:

(i) ensuring that research analyst accounts, supervisors of research analysts and associated persons with the ability to influence the content of research reports do not benefit in their trading from knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report; and

(ii) defining financial hardship circumstances, if any, in which the member will permit research analyst accounts to trade against their recommendations;

(I) prohibit explicit or implicit promises of favorable research, a particular research rating or recommendation or specific research content as inducement for the receipt of business or compensation;

(J) restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting:

(i) participation in the solicitation of investment banking services; and

(ii) participation in road shows and other marketing on behalf of issuers; and

(K) prohibit prepublication review of a research report by a subject company for purposes other than verification of facts.

(c) Content and Disclosure in Research Reports

(1) A member must ensure that purported facts in its research reports are based on reliable information.

(2) A member must ensure that any recommendation, rating or price target has a reasonable basis in fact and is accompanied by a clear explanation of the valuation method utilized and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.

(3) A member that employs a rating system must clearly define in each research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based.

(A) Irrespective of the rating system a member employs, a member must include in each research report that includes a rating the percentage of all securities rated by the member to which the member would assign a “buy”, “hold” or “sell” rating.

(B) A member must disclose in each research report the percentage of subject companies within each of the “buy”, “hold” and “sell” categories for which the member has provided investment banking services within the previous 12 months.

(C) The information required in paragraphs (c)(3)(A) and (B) must be current as of the end of the most recent calendar quarter or the second most recent calendar quarter if the publication date of the research report is less than 15 calendar days after the most recent calendar quarter.

(4) If a research report contains either a rating or price target for a subject company's security, and the member has assigned a rating or price target to the security for at least one year, the research report must include a line graph of the security's daily closing prices for the period that the member has assigned any rating or price target or for a three-year period, whichever is shorter. The graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating or price target assigned or changed on those dates; and

(C) be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date of the research report is less than 15 calendar days after the most recent calendar quarter).

(5) A member must disclose in any research report all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report, including:

- (A) if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company, and the nature of such interest;
- (B) if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;
- (C) if the member or any of its affiliates:
 - (i) managed or co-managed a public offering of securities for the subject company in the past 12 months;
 - (ii) received compensation for investment banking services from the subject company in the past 12 months; or
 - (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;
- (D) if, as of the end of the month immediately preceding the date of publication or distribution of a research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) the member or its affiliates has received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;
- (E) if the subject company is, or over the 12 month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services.
- (F) if the member or its affiliates maintain a significant financial interest in the debt or equity of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;
- (G) if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report; and
- (H) any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.

(6) A member or research analyst will not be required to make a disclosure required by paragraph (c)(5) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(7) Except as provided in subparagraph (8), the disclosures required by this paragraph (c) must be presented on the front page of research reports or the front page must refer to the page on which the disclosures are found. Electronic research reports may provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by this Rule must be clear, comprehensive and prominent.

(8) A member that distributes a research report covering six or more subject companies (a “compendium report”) may direct the reader in a clear manner as to where the reader may obtain applicable current disclosures required by this paragraph (c). Electronic compendium reports may include a hyperlink to the required disclosures. Paper-based compendium reports 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 where the disclosures can be found.

(d) Disclosure in Public Appearances

A research analyst must disclose in public appearances:

(1) if the research analyst or a member of the research analyst’s household has a financial interest in the debt or equity securities of the subject company, and the nature of such interest;

(2) if the member or its affiliates maintain a significant financial interest in the debt or equity of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;

(3) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the previous 12 months;

(4) if the research analyst received any compensation from the subject company in the previous 12 months;

(5) if, to the extent the research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of publication or distribution of the research report, was, a client of the member. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst; or

(6) any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance.

(7) A member or research analyst will not be required to make a disclosure required by this paragraph (d) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(8) Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements in this paragraph (d). Such records must be maintained for at least three years from the date of the public appearance.

(e) Disclosure Required by Other Provisions

In addition to the disclosures required by paragraphs (c) and (d), members and research analysts must comply with all applicable disclosure provisions of NASD Rule 2210 and the federal securities laws.

(f) Termination of Coverage

A member must promptly notify its customers if it intends to terminate coverage of a subject company. Such notice must be made using the member's ordinary means of dissemination to its various customers. The notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a member must disclose to its customers its reason for terminating coverage.

(g) Distribution of Member Research Reports

A member must establish, maintain and enforce policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the research report.

(h) Distribution of Third-Party Research Reports

(1) A member must establish, maintain and enforce policies and procedures reasonably designed to ensure that any third-party research it distributes:

(A) is reliable and objective;

(B) contains complete and accurate disclosures, as applicable to the distributing member pursuant to paragraph (h)(2); and

(C) contains no untrue statement of material fact and is otherwise not false or misleading. For the purposes of this paragraph (h)(1)(C) only, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading information that:

(i) should be known from reading the report; or

(ii) is known based on information otherwise possessed by the member.

(2) A member must accompany any third-party research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third-party research report.

(3) A member shall not be required to review a third-party research report to determine compliance with paragraph (h)(1)(C) if such research report is an independent third-party research report.

(4) For the purposes of paragraph (h)(2), a member shall not be considered to have distributed independent third-party research where such research is made available by a member

(a) upon request;

(b) through a member-maintained web site; or

(c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

(5) A member must ensure that a third-party research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the research report.

(i) Exemption for Members with Limited Investment Banking Activity

The provisions of paragraphs (b)(2)(A), (B), (D) and (E) shall not apply to members that over the previous three years, on average per year, have participated in 10 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; provided, however, that with respect to paragraph (b)(2)(E), such members must establish information barriers and other institutional safeguards to ensure research analysts are insulated from pressure by persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision. For the purposes of this paragraph (i), the term “investment banking services transactions” includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to paragraphs (b)(2)(A), (B), (D) and (E).

••••• **Supplementary Material:** — — — — —

.01 Pitch Book Materials. FINRA interprets paragraph (b)(2)(J)(i) to prohibit in pitch materials any information about a member's research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage. For example, FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. On the other hand, a member would be permitted to include in the pitch materials the fact of coverage and the name of the research analyst because such information alone does not imply favorable coverage.

Members 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.

.02 Disclosure of Non-Investment Banking Services Compensation. A member may satisfy the disclosure requirement in paragraph (c)(5)(D) with respect to receipt of non-investment banking services compensation by an affiliate by implementing policies and procedures reasonably designed to prevent the research analyst and associated persons of the member with the ability to influence the content of research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation. However, a member must disclose receipt of non-investment banking services compensation received by its affiliates from the subject company in the past 12 months when the research analyst or an associated person with the ability to influence the content of a research report has actual knowledge that an affiliate received such compensation during that time period.

.03 Beneficial Ownership of Equity Securities. With respect to paragraphs (c)(5)(F) and (d)(2), beneficial ownership of any class of common equity securities shall be computed in accordance with the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Exchange Act.

.04 Distribution of Member Research Products. With respect to paragraph (g), a member may provide different research products and services to certain classes of customers. For example, a member may offer one research product for those with a long-term investment horizon (“investor research”) and a different research product for those customers with a short-term investment horizon (“trading research”). These products may lead to different recommendations or ratings, provided that each is consistent with the meaning of the member’s ratings system for each respective product. However, a member may not differentiate a research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member denote a research product as one product as a means to allow certain customers to trade in advance of other customers that are entitled to the same research product. In addition, a member that provides different research products and services for certain customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research.

.05 Ability to Influence the Content of a Research Report. For the purposes of this Rule, an associated person with the ability to influence the content of a research report is an associated person who, in the ordinary course of that person’s duties, has the authority to review the research report and change that research report prior to publication or distribution.

Exhibit 2b

Alphabetical List of Written Comments

1. Amal Aly, Securities Industry and Financial Markets Association (November 14, 2008)
2. Elliot R. Curzon, Dechert LLP (November 14, 2008)
3. John I. Fitzgerald, Leerink Swann LLC (November 10, 2008)
4. Goodwin Procter LLP (November 11, 2008)
5. Daniel H. Kolber (November 10, 2008)

Exhibit 2c



November 14, 2008

Via e-mail to pubcom@finra.org

Ms. Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

**Re: Comments Regarding Proposed Research Registration and
Conflicts of Interest Rules (FINRA Regulatory Notice 08-55)**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association¹ is submitting this letter to the Financial Industry Regulatory Authority, Inc. (“FINRA”) in response to FINRA’s request for comments regarding proposed changes to its research analyst conflicts of interest and registration rules, set forth in FINRA Regulatory Notice 08-55. FINRA proposes to establish new FINRA Rule 1223 (Registration of Research Analysts) and new FINRA Rule 2240 (Research Analysts and Research Reports), the latter including new Supplementary Material (collectively, the “Proposed Rules”).

I. Introduction

First and foremost, we commend FINRA’s diligent efforts to create a comprehensive, consolidated approach to the registration of research analysts and the management of potential conflicts of interest related to research. In particular, we applaud FINRA’s adoption of many of the recommendations set forth in the 2005 Joint Report on Research by the National Association of Securities Dealers (“NASD”) and New York Stock Exchange (“NYSE”).² As a general matter, we agree with FINRA that the Proposed Rules will help ensure that investors receive objective research, while permitting the flow of information to investors and minimizing burdens on members. In

¹ Securities Industry and Financial Markets Association (“SIFMA” or the “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 Report by the NASD and the NYSE On the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules* (December 2005), available at <http://www.finra.org/web/groups/industry/@ip/@issues/@rar/documents/industry/p015803.pdf>

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particular, we strongly support FINRA's proposals to eliminate quiet period surrounding lock-ups and reduce the quiet periods for initial public offerings to 10 days. We also support the proposed, more flexible supervisory approach with respect to research analyst account trading and encourage the proposed elimination of the chaperoning mandate when reports are reviewed by non-research, non-investment banking personnel. We further support the expansion of the exemption for members with limited investment banking activities. Finally, we appreciate the guidance provided to members regarding the ways in which a member may distribute and differentiate research, including guidance regarding permissible ways for distributing different research products and services to certain classes of customers.

While we commend FINRA's efforts to produce a coherent and consolidated set of research rules, we believe there are certain critical modifications that FINRA should make to the Proposed Rules. We discuss these provisions and the modifications below.

II. SIFMA Urges FINRA to Make Certain Critical Modifications to the Proposed Rules

A. Proposed Rule 2240(b): Identifying and Managing Conflicts of Interest

1. Proposed Rule 2240(b)(2) (Preamble)

As a general matter, we endorse the overarching principle in Proposed Rule 2240(b)(1) that requires members to implement policies and procedures reasonably designed to identify and effectively manage conflicts of interest. We believe this principle appropriately captures the purpose of this rule, NASD Rule 2711, NYSE Rule 472, and Regulation AC. We also understand and support the need to set out certain specific minimum policies and procedures.

We are troubled, however, by the breadth and ambiguity of the language in the introductory sentence of Proposed Rule 2240(b)(2), "[a] member's policies and procedures must be reasonably designed to promote *objective and reliable research* that reflects the *truly held opinions* of the research analysts and to prevent the use of research reports or research analysts to *manipulate or condition the market* or *favor the interests* of the member or certain current or prospective clients" (emphasis added). That sentence is problematic in three key respects. First, it purports to require members to design procedures to promote "*reliable*" research. The concept of "*reliable*" research is new and undefined. In that regard, "*reliable*" is not a term used in NASD Rule 2711 or 2210 or NYSE Rule 472, and it is not clear whether and how it differs from the notions of objectivity and independence, which are embodied in those rules and in the Sarbanes-Oxley Act of 2002 ("SOX"). It is also not clear whether and how this new standard differs from the requirements in NASD Rule 2210 that communications be "*fair and balanced*" and "*provide a sound basis for evaluating the facts*" and in NASD IM-2210 that recommendations have a "*reasonable basis*."

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Second, the introductory sentence in Proposed Rule 2240(b)(2) is problematic because it uses the phrase “truly held” opinions. Again, the phrase “truly held” is a new and undefined concept. It is not clear what difference, if any, exists between (i) the requirement in Regulation AC that research accurately reflect the analyst's “personal views” about any and all of the subject securities or issuers, and (ii) the “truly held” opinions of research analysts referenced in the Proposed Rules.

Third, the introductory sentence of Proposed Rule 2240(b)(2) is problematic because it broadly prohibits the use of research to “*manipulate or condition the market*” or “*favor the interests of the member or certain current or prospective clients.*” While we support the general principle that members should implement policies and procedures reasonably designed to prevent market manipulation or front running of research, we believe this principle is already codified in Securities and Exchange Commission (“SEC”) and FINRA rules (in particular, Regulation M and Rule 10b-5 under the Securities Exchange Act of 1934, as amended (“Exchange Act”), and FINRA front running prohibitions in NASD-IM-2110-4. As such, it is not clear why this language is necessary or what types of activities Proposed Rule 2240(b)(2) is designed to address.

For the above reasons, we urge FINRA to delete the introductory sentence of 2240(b)(2) so the section would simply state: “Such policies and procedures must at a minimum:” Alternatively, we ask FINRA to revise the introductory sentence to state: “A member's policies and procedures must be reasonably designed to promote independent and objective research that reflects the personal views of the analyst.”

2. **Proposed Rule 2240(b)(2) (Specific Policies and Procedures To Identify and Manage Conflicts)**

With respect to the provision setting forth the specific types of policies and procedures that members are required to have, we urge FINRA to consider the following modifications:

a) **Proposed Rule 2240(b)(2)(C) (Analyst Compensation)**

Proposed Rule 2240(b)(2)(C) prohibits not only payments “based upon specific investment banking services transactions” but also those based upon “contributions to a member’s investment banking services activities.” We ask FINRA to confirm that – consistent with current rules – this prohibition does not prevent a member from compensating analysts for engaging in permissible vetting, commitment committee participation, due diligence, teach-ins, investor education, and other permissible banking-related activities. Indeed, in response to comments on an earlier set of revisions to the research analyst rules, NASD staff recognized that analysts’ participation in certain types of banking activities could be considered in compensation decisions. Specifically, in its response letter regarding these revisions, the NASD staff said that “NASD believes screening potential investment banking clients is one of many factors to measure the quality of an analyst’s research. As such, it may be considered in determining an

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analyst's compensation; [as long as] it may not be given undue weight relative to evaluating the quality of other research work product."³ The SEC also has provided interpretive guidance in the context of the Global Research Settlement⁴ that permits settling firms to compensate analysts for vetting investment banking transactions subject to certain requirements and that also permits analysts to be compensated for providing their views regarding proposed transactions or candidates for transactions, commitment committee participation, and confirming disclosures in offering or other disclosure documents.⁵

b) Proposed Rule 2240(b)(2)(D) (Analyst Compensation)

Proposed Rule 2240(b)(2)(D) should be revised so that compensation committees are required to consider the enumerated factors *only to the extent* they are applicable. By way of comparison, NASD Rule 2711(d)(2) provides that compensation committees "must consider the following factors when reviewing a research analyst's compensation, *if applicable*" (emphasis added).

We also request that FINRA include in the Proposed Rules the following additional factors that are permissible for members to consider in determining analyst compensation: (i) the analyst's seniority and experience, and (ii) the market for the hiring and retention of analysts. These factors are critical to the proper determination of analyst compensation and, as such, are specifically identified in the Global Research Settlement and similarly should be included in the Proposed Rules.⁶

c) Proposed Rule 2240(b)(2)(E) (Information Barriers)

Proposed Rule 2240(b)(2)(E) requires members "to establish information barriers and other institutional safeguards to ensure that analysts are insulated from the review, pressure or oversight of persons engaged in investment banking services activities or other persons *who might be biased in their judgment or supervision*" (emphasis added). We request that FINRA clarify that members may rely on information barriers "or" other institutional safeguards reasonably designed to ensure that analysts are shielded from such pressures. Information barriers traditionally are used to restrict the flow of material, nonpublic information and may not always be appropriate to manage potential research conflicts. In some situations, institutional safeguards that do not rise to the level of an "information barrier" are more fitting. Accordingly, we believe members should be accorded the flexibility to rely on barriers or other safeguards.

³ See Letter from Philip A. Shaikun, NASD, to James A. Brigagliano, SEC, at p. 8 (July 29, 2003).

⁴ The Global Research Settlement, which was reached among certain investment banking firms, the SEC, NYSE, NASD, and other regulators on April 28, 2003 is available at <http://www.sec.gov/spotlight/globalsettlement.htm>.

⁵ See Letter from Dana Fleischman, Cleary Gottlieb, to James A. Brigagliano, SEC, (Nov. 2, 2004), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/grs110204.htm>

⁶ See Section I.5.d of the Global Research Settlement.

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We also believe that the broad phrase "*persons who might be biased*" should be replaced with "*persons within the firm who may try to improperly influence analysts' views.*" We believe our recommended wording more accurately characterizes the types of individuals and improper conduct the rule is intended to address. As currently worded, the Proposed Rule could have unintended consequences, by requiring members to insulate an analyst from review by salespeople and investor clients because their holdings or activities may cause them to have a bias. Further, under the language of the Proposed Rules, members arguably may need to wall off an analyst from discussions with subject companies and traders because these constituencies also may have biases and could try to pressure the analyst. We believe FINRA did not intend to restrict analysts in this manner. As such, we urge FINRA to adopt our suggested language, which permits analysts to engage in legitimate and important activities, while requiring firms to have safeguards reasonably designed to protect the analysts against improper influences.

d) **Proposed Rule 2240(b)(2)(F) (Anti-Retaliation)**

Proposed Rule 2240(b)(2)(F) requires members to "prevent direct or indirect retaliation or threat of retaliation against research analysts by persons engaged in investment banking services or other employees as the result of content of a research report." This prohibition is broader than the current anti-retaliation provisions⁷ because it applies to all employees rather than just those employees involved in the member's investment banking department. Also, the proposed provision does not explicitly provide members with the ability to discipline or terminate an analyst for any cause other than the writing of an unfavorable research report as is set forth in the current rules. We believe the current anti-retaliation provisions strike a reasonable balance between preventing retaliation while preserving a member's ability to evaluate, discipline or even terminate an analyst for causes other than the writing of an unfavorable research report such as poor quality or inaccurate written work product or careless fact checking. As such, we urge FINRA retain the current language in the anti-retaliation provision set forth in current NASD Rule 2711(j).

e) **Proposed Rule 2240(b)(2)(H) (Trading by Analyst Accounts)**

As noted earlier, we support Proposed Rule 2240(b)(2)(H) that provides a more flexible supervisory approach regarding research analyst account trading in securities of companies covered by the analyst. To the extent members have adopted internal policies prohibiting analysts from owning securities issued by companies the analyst covers, we ask FINRA to confirm that members may permit an analyst to divest any such holdings pursuant to a reasonable plan of liquidation within 120 days of the effective date of the member's policy even if the sale is inconsistent with the analyst's current

⁷ See NASD Rule 2711(j) and NYSE Rule 472(g)(2).

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recommendation. This approach was proposed by the NASD and NYSE in 2007⁸ and we believe it is consistent with the principles set forth in Proposed Rule 2240(b)(H).

f) **Proposed Rule 2240(b)(2)(J)(ii) (Limitations on Analysts' Activities)**

Proposed Rule 2240(b)(2)(J)(ii) would require members to prohibit analysts' participation in road shows and other marketing on behalf of issuers. We ask that FINRA clarify that – consistent with its current rules – this prohibition does not apply to investor education activities and only applies to road shows and marketing activities “in connection with investment banking services transactions.”⁹ Under the proposed prohibition, many legitimate marketing activities that occur outside of a deal context would be prohibited. For example, analysts frequently facilitate meetings between investors and company management in what are often referred to as non-deal road shows. We believe these types of interactions are beneficial to investors and should not be prohibited by Proposed Rule 2240(2)(J)(ii).

We also ask FINRA to confirm that, consistent with existing NYSE and NASD guidance,¹⁰ analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment bankers to investors or the sales force from a remote location or, to the extent the event occurs at the member's offices, from a room that is separate from investment banking personnel, investors or the sales force.

B. Proposed Rule 2240(c): Content and Disclosure Requirements for Research Reports

We recommend that FINRA modify certain provisions in the content and disclosure requirements of the Proposed Rules so that they (i) are more consistent with existing FINRA and SEC rules and requirements, and (ii) provide clearer guidance to members regarding FINRA's expectations as set out below.

1. **Proposed Rule 2240(c)(1) (Ensuring “Purported Facts” Are Based on “Reliable Information”)**

Proposed Rule 2240(c)(1) requires members “to ensure that purported facts in reports are based on reliable information.” As we noted above, “reliable” is not a term used in current NASD Rule 2711 or 2210 or NYSE Rule 472. It is also unclear what “purported facts” are. We ask FINRA to modify this provision to require members to

⁸ See Proposed Rule Changes of the NYSE and NASD Relating to Research Analyst Conflicts of Interests, File Nos. SR-NYSE-2006-78, SR-NASD-2006-113 at 72 Fed. Reg. 2058, 2059 (Jan. 17, 2007) (“2007 Rule Proposals”).

⁹ See NASD Rule 2711(c)(5)(A). We believe that the Proposed Rule does not prohibit teach-ins or other internal meetings intended to educate the sales force, but ask FINRA to confirm our understanding.

¹⁰ See NASD Notice to Members 07-04 (Jan. 2007) and NYSE Information Memo 07-11 (Jan. 2007).

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adopt policies and procedures reasonably designed to ensure that facts are based on “sources believed by the member firm to be reliable.”

2. **Proposed Rule 2240(c)(2) (Recommendations, Ratings, and Price Targets)**

Proposed Rule 2240(c)(2) requires members to ensure that any recommendation, rating or price target has a reasonable basis “in fact.” We do not understand the reference to a reasonable basis “in fact.” In that regard, a rating or price target is, by definition, a judgment or estimate and *not* a “fact.” Accordingly, we ask FINRA to revert to the current language in the FINRA price target disclosure rule by deleting “in fact” from the proposed provision. In addition, we believe the provision should be revised to reflect that not all ratings are associated with a “valuation method.” We would revise the provision to read “. . . is accompanied by a clear explanation, including of any valuation method utilized”

3. **Proposed Rule 2240(c)(5) (Preamble to Conflicts of Interest Disclosures)**

We urge FINRA to revise the language in the introductory sentence to Proposed Rule 2240(c)(5), which broadly requires members to disclose “*all* conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the research report, including” (emphasis added).

Read literally, this language would require members to engage in a sweeping exercise to identify – with respect to every research report – *all* possible conflicts (material or immaterial) that may be known to anyone at the member. Compliance with such a standard is simply not possible. The proposed language also assumes that conflicts *could be expected and do* influence the objectivity of research reports even though FINRA’s existing research analyst rules and Reg AC assume the contrary, i.e., that potential conflicts can be managed using disclosures and certifications in order to preserve the objectivity of research analysts and research reports. In addition, this language appears to be somewhat redundant with the “catch-all” disclosure in Proposed Rule 2240(c)(5)(H), which requires disclosures of “any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.”

For these reasons, we urge FINRA to revise the language in the introduction to clarify that members must comply with the specific disclosures set forth in 2240(c)(5) (including the “catch-all” disclosure in 2240(c)(5)(H)). In particular, we ask FINRA to revise the introductory sentence to Proposed Rule 2240(c)(5) to read, “A member must disclose in any research report the following,” the language used in the preamble to current Rule 2711(h)(1) and 2711(h)(2). To the extent that FINRA wants to state a

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general principle regarding the purpose of the disclosures, we believe the rule should recognize that compliance with the specific disclosures constitutes compliance with the general principle.

4. **Proposed Rule 2240(c)(5)(F) (Disclosure of Significant Financial Interest)**

Proposed Rule 2240(c)(5)(F) establishes a new requirement that members disclose if they or their affiliates maintain a significant financial interest in the *debt* of the subject company. For a number of reasons, we believe that disclosure of financial interests in the *debt* securities of a subject company in an *equity* research report regarding the subject company is an unnecessary and burdensome requirement. First, to the extent that a member's ownership interest in a debt security may present a conflict of interest, the member is already required to disclose that interest under the catch-all provision requiring disclosures of material conflicts of interest. Also, while it is not clear what (if any) benefit this new disclosure requirement would have to investors, the costs to develop and implement this new requirement to members are clear: this new disclosure will take a significant amount of time and resources to implement because members may need to establish new methods to determine ownership thresholds and analyze and compile lists of instruments that qualify for inclusion in such calculations. Unlike equity holdings, which members were already required to calculate and aggregate with affiliate holdings pursuant to Section 13 of the Exchange Act, members do not generally identify and aggregate debt holdings among affiliates. As such, this requirement would impose significant infrastructure requirements on members and should be eliminated, given the questionable utility to investors.

5. **Proposed Rule 2240(c)(5)(H) (Material Conflict of Interest Disclosure)**

As noted above, Proposed Rule 2240(c)(5)(H) contains a "catch-all" disclosure requirement for "any other material conflict of interest..." While this disclosure is largely consistent with the current "catch-all" disclosure in NASD Rule 2711(h) and NYSE Rule 472(k), it differs in two key respects, which we believe will raise very difficult compliance issues for members. Specifically, under the current rules, members must disclose "any other actual, material conflict of interest of the research analyst or member of which the research analyst knows or has reason to know at the time of publication of the research report or at the time of the public appearance." Proposed Rule 2240(c)(5)(H), however, goes beyond the current requirement by mandating that members disclose not just *actual*, material conflicts of which the research analyst knows, but also any other material conflict of interest (including mere *potential*, material conflict of interests) that "an associated person of the member with the ability to influence the content of a research report knows or has reason to know." This proposal also goes beyond the current requirement by mandating that disclosures be made with respect to material conflicts of interest that are known not only at the time of publication, but also "at the time of the ... distribution of a research report."

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We urge FINRA to revise Proposed Rule 2240(c)(5)(H) so that it is consistent with the current research disclosure provisions. As a practical matter, it would be very difficult – if not impossible – to comply with the two new requirements in the proposal. In that regard, members would be required to delay the distribution of any research reports until they have surveyed any persons who have the “ability to influence the content of the research report” to determine whether such persons “know or have reason to know of any material conflicts.” Also, it is unclear how members could control and prevent the distribution of reports that already have been published, in order to determine whether additional disclosures are required. For example, if a member publishes a report, does it need to monitor and prevent any subsequent mailings of that report by its salespeople or other associated persons and, potentially, include additional disclosures in that report? We do not believe such a requirement would be practical or useful to investors. Indeed, to the extent any potential conflicts of interest arise after the publication of a report, such conflicts would not have influenced the substance or content of the report. For these reasons, we ask that FINRA revise Proposed Rule 2240(c)(5)(H) so that it is consistent with current disclosure requirements.

C. Proposed Rule 2240(h): Distribution of Third Party Research Reports

Regulatory Notice 08-55 describes the Proposed Rules as “incorporate[ing] in their entirety the current provisions regarding distribution and supervision of third party research” and refers the reader to Regulatory Notice 08-16, which sets out member’s disclosure and supervisory review obligations. In fact, FINRA’s proposed provisions regarding third party research reports seem to go *significantly beyond* the existing requirements in at least two respects and, as such, should be modified.

First, Proposed Rule 2240(h)(1)(A) imposes a new requirement that members adopt policies and procedures “to ensure that any third party research,” including independent third party research, “is reliable and objective.” Second, Proposed Rule 2240(h)(2) changes the third party research report disclosure requirements from specifically-delineated disclosures set out in current NASD Rule 2711(h)(13)(A) and NYSE Rule 472(k)(4)(i) to a broad requirement that members disclose “any material conflict of interest that can reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third party research report.”

In FINRA Regulatory Notice 08-16 (which is referenced in Regulatory Notice 08-55) FINRA recognized not only the value that third party research provides to investors, but also the large volume of third party research reports distributed by many members. For these reasons, FINRA revised the third party research rules to provide that “a member firm’s approval of third party research reports shall be based on a review to determine that the report does not contain any untrue statement of material fact or any false or misleading information that (i) should be known from a reading of the report or

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(ii) is known based on the information otherwise possessed by the member.”¹¹ FINRA went further by excluding all independent third party research reports from that review.

Proposed Rule 2240(h)(1)(A), however, appears to overrule the carefully-crafted balance established by Regulatory Notice 08-16 by requiring members to ensure that any third party research – *including* independent third party research – “is reliable and objective.” It is not clear what kind of review would be necessary to comply with this requirement, and, as noted above, it is not clear what would make research “reliable.” For these reasons, we urge FINRA to eliminate this new requirement in 2240(h)(1)(A) or, at a minimum, allow members to apply the same review standard and exception that are provided for in 2240(h)(1)(C).

In addition to the departures from existing guidance noted above, Proposed Rule 2240(h)(2) contains significant changes from the existing disclosure requirements for third party research. Unlike NASD Rule 2711(h)(13)(A), which required four specific disclosures for third party research (other than independent third party research) distributed by members, Proposed Rule 2240(h)(2) requires third party research reports to disclose “any material conflict of interest that can be reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third party research report.” We believe the current disclosure requirements for third party research are well-established and well-functioning. As such, we urge FINRA to do what Regulatory Notice 08-55 purports to do and adopt those existing requirements.

See Appendix for a table highlighting our suggested modifications to Rule 2240(h).

D. Proposed Changes to Definitions

1. Proposed Rule 2240(a)(4) (Revision to the Definition of “Investment Banking Services”)

The proposed revisions to the definition of “investment banking services” are overly broad, and might cover activities that are not investment banking services. As such, FINRA should retain the current definition of “investment banking services.” In that regard, the definition of “investment banking services” has been modified to cover “all acts in furtherance of a public or private offering on behalf of an issuer.” This modification creates an extremely broad definition that extends *beyond* those personnel and departments traditionally viewed as related to investment banking, and read literally, might apply to sales activities in connection with an offering or private placement. Therefore, we ask FINRA to maintain its existing definition of “investment banking services.”

¹¹ See FINRA Regulatory Notice 08-13 (April 2008) at p. 3.

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2. Proposed Rule 2240(a)(10) (Definition of “Research Report”)

We support FINRA’s proposal to exclude from the definition of “research report,” sales material analyzing open-end registered investment companies not listed or traded on an exchange and public direct participation programs. As the self-regulatory organizations have observed in the 2007 Rule Proposals, those types of sales materials are already subject to “a separate regulatory regime, including NASD Rule 2210 and SEC Rule 482, and all sales literature must be filed with the NASD Advertising Regulation Department within ten business days of first use” with certain exceptions.¹² Because sales material analyzing open-end exchange traded funds (“ETFs”) are also subject to the same regulatory regime and must be filed with FINRA within ten business days of first use, subject to certain exceptions, we urge FINRA to consider excluding such material from the definition of “research report.”

We also recommend that FINRA modify Rule 2240(a)(10)(B)(ii) to exclude from the definition of “research report” any type of periodic report or other communication for any managed client account, whether such account is “discretionary” as the rule currently provides, or non-discretionary in nature. Reports distributed to “discretionary investment accounts” are excluded from the definition of “research report” because the member’s discretion over the account presumably means the analysis provided is not for the purpose of the client’s making an “investment decision” as the definition of “research report” currently requires. The client’s representative generally makes all investment decisions for the discretionary account. We believe this rationale is equally applicable to all managed accounts, whether discretionary or non-discretionary, because clients who utilize managed accounts generally rely on their individual money manager to make investment decisions in line with their goals and will not rely upon research reports provided by the member to make “investment decisions” as required by Rule 2240(a)(10). An expansion of the exception for communications prepared for discretionary accounts to include all managed accounts would allow members to prepare written communications about portfolio managers and their funds and provide such communications to both their discretionary and non-discretionary managed clients. Accordingly, we ask FINRA revise 2240(a)(10)(B)(ii) to permit the distribution of periodic reports or other communications for investment company shareholders or *managed account* clients....”

E. Supplementary Material .01 Regarding Pitch Book Materials.

Proposed Supplementary Material .01 interprets 2240(b)(2)(J)(i) to prohibit pitch materials that suggest or imply that the member might provide favorable research coverage. The second sentence of the proposed interpretation provides an example of presumably prohibited materials that reads, “[f]or example, FINRA would consider the publication of a pitch book or related materials of an analyst’s industry ranking to imply the potential outcome of future research because of the manner in which such rankings

¹² See 2007 Rule Proposals at 2068-9.

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are compiled.” The example does not provide members with a clear understanding of what is prohibited; and, further, it is not clear why the inclusion of an analyst’s industry ranking necessarily suggests or implies that the member may provide favorable research coverage. We request that FINRA revise the example to make it clearer regarding what sort of materials are prohibited or provide an alternative example of prohibited pitch materials. We also ask that FINRA confirm that members may disclose in pitch materials the fact that research coverage will be provided for a particular issuer.

III. Web-Based Disclosures

We appreciate FINRA’s efforts to pursue more web-based disclosure options for research reports, and are disappointed that the SEC staff has chosen to interpret SOX to disallow broad use of web-based disclosures. We continue to believe that web-based disclosure promotes efficiency, provides important information to investors in a meaningful and effective manner, and is consistent with important initiatives by the SEC to promote the use of electronic media.

In particular, price charts and ratings distribution tables are often cumbersome and difficult to produce in individual research reports, and it would greatly ease production burdens and streamline the research reports themselves if they could be provided through websites. The dynamic nature of such charts and tables make them particularly well suited for online disclosure where they may provide more meaningful information to investors.

In the 2007 Rule Proposals, the NASD and NYSE asked whether a web-based disclosure regime should be permitted for public appearances.¹³ We urge FINRA to consider permitting such a regime because we believe a web-based disclosure regime is equally, if not more, appropriate for public appearances. In particular, web-based disclosures would allow investors to consider and appreciate more fully the disclosures related to public appearances. With web-based disclosures, investors would be able to download, review, and assess the disclosures (as opposed to simply hearing them recited before or after an appearance, at which time investors may not focus on the substance of the disclosures).¹⁴

IV. Request for an Extension of the Effective Date of the Proposed Rules

We believe FINRA should adopt the Proposed Rules, with the above suggested modifications, as soon as they are approved by the SEC. We request, however, that FINRA provide a 120-day “grace period” between the adoption of the Proposed Rules

¹³ See 2007 Rule Proposals at 2072.

¹⁴ We also ask FINRA to confirm that to the extent a disclosure is required by both Proposed Rule 2240 and Rule 2210 and is presented in a “compendium report” as defined by Proposed Rule 2240(c)(8), members may rely on the delivery mechanisms set forth in 2240(c)(8) to satisfy their disclosures obligations for both rules.

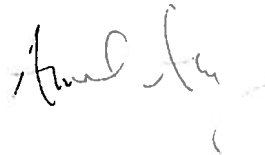
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and the implementation date of the Rules. Additional time is required because some of the Proposals, if adopted, such as the new disclosure regarding ownership of debt securities of a subject company, will require major modifications to information technology ("IT") systems and research report templates, and policies and procedures. Modifications to systems near year end are particularly difficult because many IT departments stop accepting new requests while they focus exclusively on producing year-end financials and completing existing requests.

* * * *

SIFMA appreciates the opportunity to submit this letter to you. We would be pleased to discuss this matter further and to provide any additional information you believe would be helpful in connection with your consideration of this matter. Please feel free to contact me with any questions you may have in this regard at (212) 313-1268.

Very truly yours,



Amal Aly
SIMFA Managing Director and
Associate General Counsel

CC: Mary Schapiro, Chief Executive Officer
Marc Menchel, Executive Vice President and General Counsel for Regulation
Grace Vogel, Vice President, Member Regulation
Stephen Luparello, Senior Executive Vice President, Regulatory Operations

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APPENDIX

	Current Rule*		Proposed Rule		Suggested Modifications	
	Third party research	Exception for independent third party research	Third party research	Exception for independent third party research	Third party research	Exception for independent third party research
Disclosures by distributing member firm	Four enumerated disclosures. NASD Rule 2711(h)(13)(A). *citations only to NASD rules for these purposes.	No disclosures required if independent third party research is not "distributed" by the member. NASD Rule 2711(h)(13)(B).	Disclosure of "any material conflict of interest that can reasonably be expected to influence the choice of a third party research provide or the subject company." Proposed Rule 2240(h)(2).	No disclosures required if independent third party research is not "distributed" by the member. Proposed Rule 2240(h)(4)	Maintain current disclosure requirements set forth in Rule 2711(h)(13)(A).	No modification suggested.
Review for untrue statements of material fact and false or misleading information	Review is limited to untrue statements or false or misleading information that should be known from reading the report or is known to the member. NASD Rule 2711(h)(13)(C).	Review requirement does not apply to independent third party research. NASD Rule 2711(h)(13)(D).	Review for untrue or false or misleading information that should be known from reading the report or is known to the member pursuant to Proposed Rule 2240(h)(1)(C).	Review requirement does not apply to independent third party research. Proposed Rule 2711(h)(3).	No modification suggested.	No modification suggested.
Review to ensure that research is "reliable and objective"	Not in current rule.	N/A	Requires review to ensure that third party research distributed is "reliable and objective." Proposed Rule 2240(h)(1)(A).	No exception or accommodation for independent third party research.	Eliminate this new review requirement. Alternatively, apply the standard of review set forth in Proposed Rule 2240(h)(1)(C).	Eliminate this new review requirement. Alternatively, apply the exception set forth in Proposed Rule 2240(h)(3).



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FINRA
Notice to Members

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November 14, 2008

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006

Re: FINRA Regulatory Notice 08-55

Dear Ms. Asquith:

The Financial Services Group of Dechert LLP is pleased to have the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") proposal to adopt FINRA Rule 2240 (the "Rule")¹ relating to research analysts' conflicts of interest (the "Rule Proposal").² Specifically, we are concerned that the portion of the Rule Proposal which amends the definition of "research report" to exclude sales literature relating to open-end registered investment companies that are not listed or traded on an exchange or public direct participating programs ("DPPs") is too narrow. We agree that this exclusion is consistent with the definition of research report added to the Securities Exchange Act of 1934 (the "Exchange Act") by Section 501 of the Sarbanes-Oxley Act of 2002 ("SOX"). However, consistent with Section 501 of SOX, the exclusion should also encompass sales literature relating to hedge funds and private equity funds (collectively, "private funds") so that no public or private fund sales literature would be subject to the requirements of the Rule.³

¹ Proposed FINRA Rule 2240 amends and replaces NASD Rule 2711. Unless otherwise indicated herein, all references to the Rule includes NASD Rule 2711.

² Financial Industry Regulatory Authority, Regulatory Notice 08-55, *Research Analysts and Research Reports* (Oct. 2008).

³ We note that other organizations have advanced similar, and in some cases identical, conclusions with regards to other types of investment products in connection with SR-NASD-2006-113, an earlier NASD rule filing that included the proposed change to Rule 2711. *See, e.g.*, Letter from Michael D. Udoff, Securities Industry and Financial Markets Association, to the U.S. Securities and Exchange Commission, dated March 5, 2007 (noting that sales materials related to exchange traded funds ("ETFs") and private funds should also be excluded from the definition of research report); Letter from Donald S. Weiss, Bell, Boyd & Lloyd LLP, to the U.S. Securities and Exchange Commission, dated March 1, 2007 (noting that sales materials related to private funds should also be excluded from the definition of research report); Letter from Jack Hollander, Investment Program Association, to the U.S. Securities and Exchange Commission, dated March 5, 2007 (noting that sales materials related to non-traded real estate investment trusts should also be excluded from the definition of research report); Letter from David A. Hebner, Wachovia Securities, LLC, to the U.S. Securities and Exchange Commission, dated February 28, 2007

Dechert is an international law firm serving clients in the United States and worldwide. The Financial Services Group of Dechert provides advice and assistance to a wide variety of U.S. and non-U.S. investment companies and private funds, as well as investment advisers, fund administrators, broker-dealers, insurance companies, commercial banks, and thrift institutions. An extensive part of our services for these clients involves assistance in compliance with federal and state securities laws in the organization, distribution, and operation of investment funds, including those registered with the Commission and those not subject to registration. The comments that follow reflect our own views and not necessarily those of any client of the firm.

As we explain in detail below, and based on the rationale previously advanced by FINRA,⁴ sales literature relating to private funds, the attributes of which are similar to those of sales literature relating to open-end registered investment companies and public DPPs, should also be excluded from the definition of “research report.” Additionally, the public policy concerns that prompted the adoption of the conflict of interest rules for research analysts – and the concerns that justify regulating “research reports” – are not present in the context of sales literature relating to private funds.

I. Background

The Rule’s definition of “research report,” which was adopted in whole from Section 15D(c)(2) of the Exchange Act, is a “written (including electronic) communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.”⁵ Section 15D, added to the Exchange Act by SOX Section 501, mandated the adoption of rules to “address conflicts of interest that can arise when securities analysts recommend equity securities in research reports . . . in order to improve the objectivity of research and provide investors with more useful and reliable information.”

The breadth of the definition of “research report” has created significant uncertainty about the scope and application of the Rule, including its application to mutual fund sales literature. The *Joint Report by NASD and the NYSE on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules*, published in December 2005 (the “Joint Report”), noted the very broad definition of “research report,” and recommended codifying certain interpretations of the definition so that the Rule would not apply to sales literature relating to “registered investment companies.” (The Joint Report did not include the qualifier “open-end” to registered investment companies, which is in the Rule Proposal.) The Rule Proposal, among other things, amends the definition of “research report” to exclude sales literature relating to open-end registered investment companies that are not listed or traded on an exchange or public DPPs.

(noting that sales materials related to ETFs, closed-end funds and hedge funds should also be excluded from the definition of research report).

⁴ See *Self-Regulatory Organizations; New York Stock Exchange LLC and the National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Changes to Amend NYSE Rules 472 and 344, and NASD Rules 1050 and 2711 Relating to Research Analyst Conflicts of Interest*, Securities and Exchange Commission (“SEC”), Release No. 34-55072, SR-NASD-2006-113 (Jan. 9, 2007) (the “2006 Rule Proposal”).

⁵ NASD Rule 2711(a)(9).

In connection with the distribution of private funds, registered broker-dealers produce sales literature that is directed to accredited investors interested in private funds and that contains information, such as performance information, about private funds, which a fair reading would lead one to believe may be "sufficient upon which to base an investment decision," i.e., a "research report." After the Joint Report was published, FINRA staff verbally reiterated to us their belief that the Rule applies to private fund sales literature. Accordingly, and consistently with the observation of the Joint Report, we have assumed that it is FINRA's view that the Rule applies to private fund sales literature.

II. The Proposed Exclusion Should Be Expanded Consistent With the Apparent Purpose of the Definition of Research Report and to Eliminate Confusion

We urge FINRA to expand the proposed exclusion so that the Rule will not apply to private fund sales literature because the risks that the Rule is intended to address are absent with respect to sales literature relating to securities that are not traded in secondary markets or that are redeemable by the issuer. Instead, the proposed exclusion should be expanded so that the definition of "research report" is limited to communications: (i) relating to equity securities that are traded in public secondary markets, (ii) relating to equity securities that are not redeemable at the option of the investor, and (iii) published by a person who is not the distributor or agent of the issuer.

Section 15D and the Rule were not intended to address communications that are clearly presented as sales literature and that are governed by the rules and standards applicable to sales literature. While sales literature is expected to be "fair and balanced,"⁶ there should be no expectation that it is objective analysis. Accordingly, we believe the Rule Proposal should be amended to ensure that sales literature relating to private funds is not subject to the requirements of the Rule. Moreover, sales literature that is clearly marketing material and not objective analysis should not be subjected to the additional regulatory regime designed to preserve the objectivity of research.

Subjecting broker-dealers distributing private funds, as well as foreign funds sold in private placements in the United States and other types of equity alternative collective investment products, to the Rule's requirements is unnecessary because, as discussed in IV.A, below, private fund distribution practices were not the reason behind adopting the Rule. Imposing the requirements of the Rule on private fund distributors will affect the use of offering summaries, pitch books, power-point presentations, term sheets and other commonly used forms of sales literature that are not prospectuses or offering memoranda.⁷

⁶ See NASD Rule 2210(d)(1).

⁷ NASD, SR-NASD-2006-112, *Proposed Rule Change to Amend NASD Rule 2711 to Codify Existing Interpretive Guidance Relating to Research Analyst Rules*, filed for immediate effectiveness on Sept. 27, 2006 and published at 72 F.R. 62331 (Oct. 24, 2006), codified an interpretation that excludes "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" from the definition of "research report." This change clearly permits performance information in prospectuses and offering memoranda, while the Rule Proposal's exclusion is more limited and would prohibit the use of performance information in private fund sales literature that is not a prospectus or offering memorandum.

As noted above, FINRA apparently takes the position that the Rule applies to all types of sales literature that meet the definition of research report, whether such sales literature relates to private funds, public closed-end funds, ETFs and other equity alternative investment products. In our experience we have found that private fund distributors are generally unaware that FINRA takes this counterintuitive and surprising view.⁸ Moreover, the fact that few are aware of FINRA view of the Rule's scope indicates confusion over the scope and application of the Rule with regard to private fund sales literature. This lack of awareness and confusion may also indicate that the effect of the Rule and its costs and benefits were not fully understood nor adequately considered at the time the Rule was adopted.⁹

III. FINRA's Rationale for Exempting Open-End Registered Investment Companies and Public DPPs From the Rule Applies Equally to Private Funds

Although not addressed in detail in the Rule Proposal, the 2006 Rule Proposal justified excluding from the definition of "research report" sales literature of open-end registered investment companies because such sales literature is subject to a separate regulatory regime, including FINRA Rule 2210 and SEC Rule 482, both of which set the content standards for sales literature.¹⁰ FINRA also noted that registered fund sales literature is subject to filing with FINRA within ten days of its first use, but does not explain how the filing requirement justifies limiting the exclusion to open-end registered investment companies. We urge FINRA to consider that the filing requirement applicable to registered fund sales literature is a procedural requirement designed to assure that widely distributed registered fund sales literature is subject to orderly review, while private fund sales literature, because of its more sophisticated audience and limited non-public distribution, need not be subject to intensive review. Accordingly, the justification for the distinction FINRA draws between registered fund sales literature and private fund sales literature – that registered fund sales literature is subject to FINRA review – should not be considered a substantive protection that supports limiting the proposed exclusion to registered fund sales literature. The content requirements of FINRA Rule 2210 are equally applicable to both registered and private fund sales literature. Moreover, the Rule 482 requirements applicable to registered fund sales literature arise because of the need to reconcile such sales literature with the prospectus requirements of the Securities Act of 1933 ("Securities Act").

FINRA also proposed to exclude public DPP sales literature because it is subject to FINRA Rule 2210, including the requirement that it must be filed with FINRA within ten business days of its first use. The 2006 Rule Proposal noted that the sales literature of DPPs generally consists of "tombstone" advertisements and, therefore, is also subject to SEC Rule 134. FINRA asserted that public DPPs

⁸ A review of the relevant literature has not identified any instance in which FINRA has publicly stated its expectation that the Rule would apply to private fund sales literature, nor are we aware of any instance where FINRA has sought to enforce the Rule against publishers of such sales literature. Nevertheless, the effect of comment letters such as the ones cited in footnote 3, above have highlighted for the first time the fact that industry participants believe there is ambiguity which FINRA should resolve.

⁹ We note that the definition of "Research Report" in the Rule is the same as the definition in SEC Regulation AC.

¹⁰ See 2006 Rule Proposal, *supra*, note 4. Because the Rule Proposal does not address the proposed definition of "research report," we will address the reasoning offered by the 2006 Rule Proposal, which attempted to amend the definition of "research report" in the same manner as the Rule Proposal.

typically are not traded on an exchange and do not have an active secondary market.¹¹ FINRA did not cite any source for this assertion. Public DPPs are sometimes exchange listed or traded in the secondary market because they are registered. In fact, it is precisely these characteristics that appear to make public DPPs more akin to individual operating company equity securities. Unregistered funds that are organized as DPPs or limited liability companies, by contrast, generally do not trade in secondary markets because of their structural characteristics such as redemption restrictions and resale prohibitions.

FINRA Rule 2210 regulates the content of private fund sales literature¹² and requires sales literature to be based on “principals of fair dealing and good faith.” Sales literature must be fair and balanced and must not omit any material facts if the omission, in light of the context, would cause the communication to be misleading.¹³ In addition, Rule 2210 prohibits members from making any false, exaggerated, unwarranted or misleading claim in communications with the public, and communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated claim, opinion or forecast. Rule 2210 also specifies that sales literature must disclose the relationship between the registered broker-dealer and the non-member or individual who is named. Finally, even if a non-member private manager prepares the sales literature, the sales literature is subject to the content requirements of Rule 2210 if a member uses it to sell a private fund.¹⁴

Although private fund sales literature is not subject to post-use review by FINRA, such review is not necessary.¹⁵ Unlike open-end registered investment companies and public DPPs, the distribution of private fund sales literature is limited to sophisticated investors.¹⁶ These investors are considered more

¹¹ See *id.* at 11.

¹² The NASD and others have interpreted Rule 2210 to apply equally to the sales literature of registered funds and private funds. See NASD, Interpretative Letter, *Further Interpretative Advice to Members Concerning the Sale of Hedge Funds* (Oct. 2, 2003) [hereinafter SIA Letter]; see also NASD, Interpretive Letter, *Guidance Regarding Use of Related Performance Information in Sales Material for Private Equity Funds* (Dec. 30, 2003) [hereinafter Davis Polk Letter].

¹³ See NASD, IM-2210-1, *Guidelines to Ensure That Communications With the Public Are Not Misleading*; see also NASD, Notice to Members 03-07, *NASD Reminds Members of Obligations When Selling Hedge Funds* (Feb. 2003).

¹⁴ See SIA Letter, *supra* note 12.

¹⁵ The 2006 Rule Proposal noted that the “NASD Advertising Regulation Department review of registered investment company and public DPP sales literature reduces the likelihood that it will contain content that is not fair and balanced.” 2006 Rule Proposal, *supra* note 4; see also Davis Polk Letter, *supra* note 12; SIA Letter, *supra* note 12.

¹⁶ Sophisticated investors are investors that are “qualified institutional buyers,” as defined by Rule 144A under the Securities Act, “qualified purchasers,” as defined by Section 2(a)(51) of the Investment Company Act of 1940 (“Investment Company Act”), or “accredited investors,” as defined by Rule 501(a) under the Securities Act.

Though the SEC is proposing to revise the definition of “accredited investors,” as it applies to natural persons, the SEC is not proposing to change the principle that select investors do not need as much regulatory protection as the public. SEC, Release 33-8766, *Prohibition of Fraud by Adverse to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles* (Dec. 27, 2006) (proposing new standards to limit the number of investors that qualify as accredited investors because overall personal wealth has increased, as a result of inflation and increased personal residence values, so

capable of objectively evaluating sales literature and, therefore, the concerns related to the widespread public dissemination of research are not present. In fact, FINRA, in an interpretive letter concerning a particular class of private funds, noted that, with respect to related performance in sales literature, private funds do not present the same investor protection concerns compared to mutual funds.¹⁷ Private funds also are generally not subject to the registration requirements of the Investment Company Act and Securities Act because their shares are sold to sophisticated investors in limited offerings.¹⁸ Because sales literature for private funds is subject to the same content standards as apply to open-end registered investment companies and public DPPs, FINRA's justifications for the scope of the proposed exclusion should apply equally to private fund sales literature. Finally, any performance information in private fund sales literature must meet the same Rule 2210 requirements that apply to registered investment companies.¹⁹ Accordingly, we urge FINRA to consider that, because Rule 2210 sets content standards for advertising and sales literature, it should not impose additional regulatory burdens on private fund sales literature by declining to extend the proposed exclusion.

IV. Regulatory Concerns Justifying the Regulation of Research Reports Do Not Apply in the Context of Private Fund Sales Literature

A. Private Funds Are Priced at Net Asset Value, Not by the Market

The conflicts of interest that FINRA sought to address when enacting Rule 2711 are not a regulatory concern for private funds. FINRA adopted the Rule to address the influence that investment bankers exerted on research analysts to speak favorably about specific companies or issuers.²⁰ FINRA noted that "[t]he primary biasing forces came from investment bankers who pressured research analysts to speak favorably of current and prospective clients and, with management acquiescence, linked analysts' compensation directly to their role in landing lucrative investment banking deals."²¹ FINRA was concerned with research analysts having a financial interest in the issuers that they covered and, as a

that the percentage of U.S. households that qualify for accredited investor status has increased from 1.87% to 8.47% between 1982 and 2003, while investment products have increased in complexity).

¹⁷ Davis Polk Letter, *supra* note 12.

¹⁸ *See id.*

¹⁹ *See id.*

²⁰ The NASD sought to address the circumstances that compromised the objectivity of research by research analysts "and to restore public confidence in the validity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities." *Id.* at 2.

²¹ Joint Report, *supra* at 2 ("In the succinct words of a retired Wall Street research analyst who testified before Congress in the summer of 2001: 'Investment banking now dominates equity research.'"). Congress expressed similar concerns when addressing research analysts' conflicts of interest. *See* S. COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002, S. Rep. No. 107-205, at 41 (2002) ("The Committee [on Banking, Housing and Urban Affairs] heard persuasive testimony that a serious problem exists regarding conflicts of interest between Wall Street stock analysts and their employing brokerage firms, on the one hand, and the public companies that the stock analysts cover, on the other hand. Growing knowledge of these conflicts is harming the integrity and creditability to the public of stock analyst recommendations.") (emphasis added).

result, attempting to manipulate the price of securities traded on an exchange through the issuance of unduly favorable research reports.²²

By contrast, it is impossible to manipulate the price of a private fund. A private fund's value is calculated in the same manner as the value of an open-end registered investment company—using the fund's net asset value ("NAV"). Because private fund sales literature cannot affect the NAV of a private fund, subjecting such sales literature to regulation under a rule that was designed to prevent price manipulation is unnecessary, burdensome, and contrary to legislative intent.

B. Private Fund Sales Literature Does Not Contain Analysis

Private fund sales literature is more similar to open-end registered investment company sales literature than to single operating company equity security research reports. A "research report" has (i) "information reasonably sufficient upon which to base an investment decision" and (ii) "analysis" about securities of "individual companies." Although investors may use private fund sales literature to decide whether to purchase or sell a fund, private fund sales literature does not generally contain the type of analysis that is included in research reports for operating companies. Nor is the type of analysis performed on operating companies applicable to the private funds. The two main types of analysis that are in research reports for operating companies are technical analysis²³ and fundamental analysis. Technical analysis refers to:

research into the demand and supply for securities, options, mutual funds and commodities based on trading volume and price studies. Technical analysts use charts or computer programs to identify and project price trends in a market, security, fund or futures contract. Most analysis is done for short- or intermediate-term, but some technicians also predict long-term cycles based on charts and other data.²⁴

Fundamental analysis is the:

analysis of the balance sheet and income statements of companies in order to forecast their future stock price movements. Fundamental analysts consider past records of assets, earnings, sales, products, management and markets in predicting future trends in these indicators of a company's success or failure. By appraising a firm's prospects, these analysts assess whether a particular stock or group of stocks is undervalued or overvalued at the current market price.²⁵

²² Conflicts included basing analysts' compensation on their contributions in support of investment banking transactions and the profitability of the investment banking unit, as well as analysts covering companies underwritten by the analysts' firms; investing in pre-initial public offerings of companies that they initially covered and for which their firms had acted as underwriters; and issuing favorable research reports or "buy" recommendations close to the expiration of a lock-up period. *Id.*

²³ FINRA asserted that, in the discussion of the definition of "research report" under the research analyst rules, it would not exclude technical or quantitative analysis from the definition of research report. *See* NASD Notice to Members 04-18, *Research Analysts and Research Reports* (March 2004)

²⁴ Dictionary of Finance and Investment Terms, 548-49 (4th ed. 1995).

²⁵ *Id.* at 211.

Technical analysis is not applicable to a registered fund or private fund. Demand and supply, the basis of technical analysis for operating companies, do not influence the price of a registered fund or private fund, because, as noted earlier, a fund's price is based on the net value of its underlying portfolio securities. For example, the newsletters that broker-dealers produce include information about economic and market developments, but such information is general and is not about the underlying portfolio securities of the funds in which the investor is investing.

Similarly, with regard to fundamental analysis, analyzing assets, earnings, sales, products, management and markets in order to identify trends in a private fund would be meaningless because, in some cases, there is no such information, and, in other cases, only the information that relates to the underlying portfolio securities is meaningful. This information would not be about the private fund in which the investor is investing.

Finally, analysis in any of its forms involves the separate examination of constituent parts of an "individual company" engaged in commercial or industrial enterprises to form conclusions as a consequence of reasoning.²⁶ Unlike a single operating company equity security, which may be separated into its constituent parts (*e.g.*, price and market data, financial statement information, etc.),²⁷ a private fund is not composed of the same constituent parts of an operating company. Any analysis of a private fund would be problematic because a particular portfolio's securities are both concealed and ever changing.

FINRA should recognize that sales literature, regardless of whether the subject matter is a registered fund or private fund, is not a research report within the context of the Rule because it does not contain the technical or fundamental components of analysis. In addition, information about private funds does not contain information about individual companies that produce a product or provide a service.

Finally, private fund sales literature is likely to include information about the characteristics of the product and an assessment of its manager. Typically, this may be a restatement of information provided in fund offering documents (such as management style and tax consequences) coupled with personal evaluations. This type of discussion in the context of registered funds is not analysis²⁸ and, accordingly, should not be considered analysis in the context of private funds.

IV. Conclusion

For the foregoing reasons we urge FINRA to extend the Rule Proposal to exclude from the definition of "research reports" the sales literature of private funds because the risks that the Rule is intended to address are not present with respect to sales literature relating to securities that are not traded in secondary markets or that are redeemable by the issuer. Sales literature that is clearly marketing material and not objective analysis should not be subjected to the additional regulatory regime designed to preserve the objectivity of analysis. FINRA's previously articulated rationale for excluding from the definition of "research reports" the sales literature of open-end registered investment companies and public DPPs (*i.e.*, that Rule 2210 regulates such sales literature) applies equally to private funds. Finally, the regulatory concern that private fund sales literature will manipulate the value of a private fund is not

²⁶ See Webster's II New Riverside University Dictionary, 104 (1984).

²⁷ See Black's Law Dictionary (5th ed. 1979).

²⁸ FINRA staff, in discussions about interpreting the Rule, made this observation.

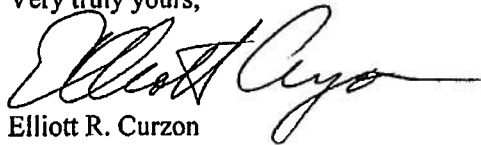
Dechert
LLP

Marcia E. Asquith
November 14, 2008
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an issue because private funds are priced at NAV, not by the market. In addition, private fund sales literature does not contain the type of analysis that research analysts manipulated, and this manipulation is what led to the adoption of Rule 2711.

We appreciate the opportunity to comment on this Rule Proposal. If you have any questions concerning the foregoing, please contact me. Thank you for your attention to this matter.

Very truly yours,



Elliott R. Curzon

cc: James A. Brigagliano
Associate Director SEC Division of Trading and Markets

Marc Menchel
FINRA Regulatory Policy and Oversight's Office of General Counsel



LEERINK SWANN

November 10, 2008

Via Electronic Transmission (pubcom@finra.org) and Overnight

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 08-55

Dear Ms. Asquith:

Leerink Swann LLC ("Leerink")¹ is submitting this letter in response to the request by FINRA for comments on the Proposed Research Registration and Conflict of Interest Rules ("Notice")².

We appreciate and thank you for the opportunity to comment on the Notice, and, for the purpose of this letter, will initially comment on several of the proposed changes to quiet periods and lock-ups the firm supports and then focus our comments on two narrow and distinct issues. Those issues are: 1. the proposed restriction or limitation of research analysts participating in road shows or other marketing on behalf of issuers³; and 2. the selective distribution of research reports⁴.

Quiet Period and Lock-Ups

We agree with the proposed changes to reduce the existing forty-day post-IPO research quiet period to ten days and the elimination of the black-out periods after a secondary offering and those surrounding the expiration of lock-up agreements⁵. The investing public stands to benefit from the

¹ Leerink Swann LLC is a SEC-registered broker-dealer and a member of FINRA.

² See FINRA Regulatory Notice 08-55 ("Notice")

³ See Proposed Rule 2240(b)(2)(J)(ii)

⁴ See Proposed Rule 2240(g)

⁵ See Proposed Rule 2240(b)(2)(G)

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issuance of research containing valuable market information during those periods.

Those proposed changes are positive steps. The comments below raise questions relating to other proposals that require more discussion and consideration before submission to the Securities and Exchange Commission.

Marketing Initiatives

Rule 2711 was adopted in 2002 with the purpose of improving "the objectivity of research and provide investors with more useful and reliable information when making investment decisions."⁶ The Rule was later amended in 2003 to include a provision prohibiting analysts from participating in efforts to solicit investment banking business, including "pitches" for investment banking business to prospective investment banking clients.⁷ The stated purpose of the NASD in adopting the prohibition was "to further the overriding goals of research objectivity and investor confidence by eliminating all participation by research analysts in solicitation efforts that could suggest a promise of favorable research in exchange for underwriting business."⁸

The current version of Rule 2711(c)(5) prohibits research analysts from participating in a road show related to an investment banking services *transaction* (emphasis supplied) and from communicating with current or prospective customers in the presence of investment banking department personnel or company management about such an investment banking services *transaction* (emphasis supplied). In submitting the proposal to amend Rule 2711 relating to road shows to the SEC on September 17, 2004, NASD stated that "by prohibiting research analyst participation in road shows, the proposed rule change will further reduce the pressure on research analysts to give an

⁶ See NASD Notice to Members 02-39, page 1

⁷ See NASD Notice to Members 03-44

⁸ See letter from Philip A. Shaikun, Associate General Counsel (NASD) to James A. Brigagliano, Esq., Assistant Director, Division of Market Regulation, dated July 29, 2003, Page 7.

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overly optimistic assessment of a particular transaction."⁹ Recognizing, however, that analysts provided a valuable service in the marketplace, the proposal allowed for research analysts to educate investors about a particular offering or other transaction, so long as the communication occurred outside the presence of the company or investment banking department personnel. This exception preserved the ability of the research analyst to give a candid assessment of a *transaction or sale of securities*¹⁰ (emphasis supplied). In announcing the approval of the amendment in Notice to Members 05-34 in May 2004, the NASD again stated that the rule, as amended, would "further reduce pressure on research analysts to give an overly optimistic assessment of a particular *transaction*"¹¹ (emphasis supplied).

Interestingly, on September 24, 2004, one week after the amended proposal referenced *supra* was filed with the SEC, Judge Pauley approved the terms of Addendum A to the Global Research Analyst Settlement. Undertaking 11 prohibited research personnel at the settling firms "from participating in company-or Investment Banking-sponsored road shows related to a public offering or other investment banking *transaction*"¹² (emphasis supplied).

It is clear that the intent of the regulatory authorities for the past seven years was to allow the research analyst to offer a candid assessment of a transaction or sale of securities outside of the presence of either his firm's investment bankers or representatives of the company. Proposed Rule 2240(b)(2)(J)(ii) prohibiting analysts' "participation in road shows and other marketing on behalf of issuers"¹³ eliminates an important condition that the prohibition relate to the analyst's participation

⁹ See File No. SR-NASD-2004-141, dated September 17, 2004, Page 5

¹⁰ *Id*

¹¹ See NASD Notice to Members 05-34, May 2005, page 2

¹² See Section 11.a of Addendum A, Undertakings, approved September 24, 2004

¹³ See fn 3

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in the marketing of a specific investment banking services transaction. Is it possible that FINRA intends to prohibit all participation in marketing by research analysts whether or not related to investment banking services? If that is the purpose, how then can "analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities"¹⁴ carry out that role? Clarification is required and FINRA should understand the implications for issuers, private investors and institutions. Clearly, the impact will also be felt by companies - both private and public. Not every contact with a company should be looked at as marketing the investment banking services of the analyst's firm or jeopardizing the analyst's objectivity.

Research analysts are expected to analyze and understand the industry or sector they cover. Not every company will be a banking client or prospect of the analyst's firm at any given moment. We all know that things can change rapidly in today's financial services' world and opportunities, once unreachable, can develop overnight. How can the analyst be an unbiased intermediary if he is not able to take advantage of what companies make available to him in the way of marketing themselves?

Companies regularly sponsor analyst days to help analysts better understand the products, meet management and tour facilities. This activity is marketing in its purest sense. The proposed rule would appear to prohibit the analyst from attending one of these events if institutional investors or analysts from other firms were also in attendance. Would companies be forced to limit attendance to one analyst at a time or would one-on-one meetings also be prohibited?

Companies will often approach firms to provide an audience so that the company's management team can tell its story to salespeople and clients. Firms may often be able to provide exposure to some of its clients, particularly

¹⁴ Notice at 2

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institutions and their portfolio managers, that the companies cannot otherwise obtain. The questions raised by salespeople and portfolio managers and their reaction to the story are of particular value to the analyst in better understanding sectors and industries, competitive issues, industry trends, etc. in order for him to serve as an unbiased intermediary. The benefit to the company in speaking with investment professionals cannot be overlooked. Would the proposed rule prohibit the analyst from attending these company marketing presentations if clients participate? If only the salespeople attend, can the analyst participate or would the analyst need to leave the room?

FINRA members often sponsor widely-attended, invitation-only client conferences and roundtables providing a large number of companies - both public and private - the opportunity to tell their stories to investors. Analysts will often moderate many of the sessions at these events. The sessions may include a number of different companies in the same sector discussing their products with the institutional clients. Again, a marketing initiative for companies facilitated by FINRA members. Will participation by analysts in these events be prohibited? Would they even be permitted to attend?

How do institutional clients value this access to company management? Company marketing is considered an integral part of the role of sell-side analysts and during company marketing meetings, it is standard industry practice for the companies to be accompanied by analysts. In surveys of institutional clients conducted by *Institutional Investor* over the past five years, "Management Access" has consistently ranked among the top priorities at either 4th or 5th. Considered by many to be the most prominent survey in the industry, the 2008 survey consulted 3000 individuals at 830 firms, including 87 of the then largest U.S. money managers.¹⁵

¹⁵ *Institutional Investor*, October 2004-2008

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According to a proprietary report based on 1,052 in-person interviews with buy-side analysts from 395 targeted institutions and 230 interviews with portfolio managers from 506 targeted firms during the period of November 2007 through March 2008 conducted by Greenwich Associates, company marketing is a well-entrenched practice which institutions value highly and for which they directly allocate commissions¹⁶. Direct access to companies' management (non-deal road shows, one-on-one meetings and conference calls) was considered in two ways: 1. as one of twelve qualitative factors in the Greenwich Quality Index; and 2. indications from buy-side firms of the percentage of commissions they pay for this direct access. In the survey, direct access to companies' management was the number two priority in allocating commissions. This result has been consistent throughout the past three years. In terms of actual amounts, buy-side analysts allocate 22% of commissions and buy-side portfolio managers allocate between 20-25% for this access. This empirical evidence clearly demonstrates the importance of research analysts continuing to be able to participate in these marketing events.

Research conferences and seminars were also included in the Greenwich survey and over the past three years were ranked as a high priority in allocating commissions. Analysts for buy-side firms responding ranked research conferences and seminars as the number three priority representing 13% of commissions allocated to the sell-side. Portfolio managers ranked the activity as number four representing 12% at both small and large clients.

A significant number of institutional clients demonstrate their view of the sell-side firms through portfolio manager and analyst votes on a quarterly, semi-annual or annual basis. These votes are important feedback to sell-side managers for the votes tell you what the firm does well and what it may need to improve upon. In one recent vote received by this firm, the management of the buy-side firm indicated that approximately 31% of

¹⁶ Greenwich Associates ("Greenwich"), 2008

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commissions allocated were for company marketing meetings as "meetings with corporate management are the most highly valued service our brokers can provide ... Points are awarded for small group meetings, one-on-ones at conferences, meetings in our office or field trips your analysts arrange to corporate headquarters". These type of comments are frequently made as demonstrated in the results of the *Institutional Investor* and Greenwich Associates surveys.

Marketing is an important component for all companies. The questions raised *supra* require further consideration in advance of any rule filing with the Securities and Exchange Commission.

Distribution of Member Research Reports

Proposed Rule 2240(g) is meant to codify FINRA's existing interpretation of Rule 2110 with regards to the timing and distribution of research reports and provide additional guidance concerning firms offering different research products and services to certain classes of clients with the proviso that the firm discloses its research dissemination practices¹⁷. The proposed rule and Supplementary Material raise a number of issues and necessitate clarification by FINRA.

The existing interpretation¹⁸ referred to in the Notice appears to be narrower than represented in the Notice as it addresses the issue of a member firm's trading activities that occur in anticipation of a firm's issuance of a research report. The published interpretation does not permit a firm to purposefully change its inventory position through "trading activities undertaken with the intent of altering a firm's position in a security in anticipation of accommodating investor interest once the research report has been issued¹⁹". While the published interpretation does not refer to clients, firms understand that FINRA views

¹⁷ Notice, Proposed Supplementary Material .04

¹⁸ See IM-2110-4

¹⁹ *Id*

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improperly giving advance notice of research reports and ratings to institutional (or other) clients as violating regulatory standards²⁰ and support that position. To the same end, in a subsequent rule filing submitted to adopt FINRA Rule 5280 (Trading Ahead of Research Reports), FINRA again addresses the issue of front-running research reports stating it "believes that a member should have an affirmative obligation to manage conflicts of interest in trading securities."²¹ FINRA goes on to say that the proposal "will protect the investing public by preventing firms from utilizing non-public advance knowledge of the timing or content of a research report to benefit its own trading to the detriment of its own customers."²² FINRA describes this approach as "more consistent with existing and proposed rules regarding supervision and the requirements of NASD Rule 2711 and NYSE Rule 472 to eliminate conflicts involving the publication and distribution of research reports."²³

The Proposed Supplementary Material expands the existing interpretation to impose new requirements on firms that provide different research products and services - not solely research - for certain clients. Specifically, member firms would be required to inform its other clients that its alternative research products and services may reach different conclusions or recommendations that could impact the price of a security²⁴. It must be emphasized that the proposal would now extend beyond "research reports", a defined term, to "research products and services", which is not defined. In the investment business (as in many others), clients that generate more commissions receive different levels of service and products. These products and service levels are varied and may not always relate to recommendations or ratings. In the institutional business, tiered relationships are rarely memorialized by written agreement. Firms rely on institutional salespeople and

²⁰ See Phua Young, NASD Complaint, May 28, 2003.

²¹ See File No. SR-FINRA-2008-054 dated October 29, 2008, page 6

²² *Id.*, page 7

²³ *Id.*, page 6

²⁴ *Greenwich*

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sales traders to "cover" clients and discuss levels of service with clients. In reality, clients in the institutional world understand that more commissions will result in more attention. The simplest way for a client to express its dissatisfaction with a sell-side firm is to stop sending order flow. Conversely, sell-side service may drop in relation to commission flow from the buy-side.

A number of questions arise:

1. Is the use of the term "research products and services" meant to only apply to "research reports"?
2. If not, what is the definition of "research products and services"?
3. Is proposed Rule 2240(g) and proposed Supplementary Material .04 meant to apply solely to prohibiting a firm offering a trading advantage to one type of client over another client?; and
4. Should a carve-out from the notification provision be included for institutional clients? If not, can the notification be provided orally?

FINRA should provide clarification for the issues identified *supra*.

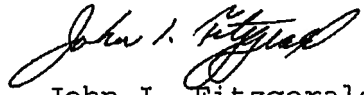
We recognize FINRA's objective to establish a "principle based" regulatory environment allowing a firm to develop policies and procedures based on the individual firm's size and business model. Clarification, however, is needed to allow firms to better understand how the specific proposals discussed *supra* "further the overriding goals of research objectivity and investor confidence".

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If you have any questions or wish to discuss the
comments, please contact me at 617-918-4564.

Very truly yours,

A handwritten signature in cursive script, appearing to read "John I. Fitzgerald".

John I. Fitzgerald

JIF/gct

GOODWIN | PROCTER

Goodwin Procter LLP
Counselors at Law
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Boston, MA 02109

T: 617.570.1000
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November 11, 2008

VIA E-MAIL: pubcom@finra.org

Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
Attn: Marcia E. Asquith

Re: Regulatory Notice 08-55 - Research Analysts and Research Reports

Dear Ms. Asquith:

On behalf of The National Venture Capital Association (the "NVCA"), we appreciate the opportunity to provide comments to FINRA on Regulatory Notice 08-55 on proposed FINRA Rules 1223 and 2240 regarding research analyst conflict of interest rules.

The NVCA is the premier trade association that represents the U.S. venture capital industry. It is a member-based organization, consisting of venture capital firms that manage pools of risk equity capital dedicated to be invested in high growth, entrepreneurial companies. NVCA's mission is to foster greater understanding of the importance of venture capital to the U.S. economy, and support entrepreneurial activity and innovation. The NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provides reliable industry data, sponsors professional development, and facilitates interaction among its members. Over the last ten years, venture-backed companies represented approximately 25 percent of initial public offerings in the U.S.

The NVCA supports FINRA's efforts to achieve a balance between ensuring objective and reliable research on the one hand, and permitting the flow of information to investors and minimizing costs and burdens to member firms on the other. We agree with FINRA that liberalizing the availability of research will provide investors with valuable market information, and that the other provisions of the research rules and SEC regulations are sufficient to protect the integrity of such research.

The proposed rules would benefit IPO issuers in particular by making research coverage available more quickly, easing restrictions on research coverage around lock-up expirations, waivers and terminations, providing greater flexibility to waive or modify lock-ups and making negotiation of lock-up agreements easier. We note, however, that the 25-day prospectus delivery

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requirement of the Securities Act may result in underwriters self-imposing a 25-day quiet period in connection with initial public offerings. Similarly, underwriters and issuers may have concerns that research issued shortly after a secondary offering could result in prospectus liability.

Overall, we believe the proposed rules are a step in the right direction, but that more can and should be done to restore the competitive position of the U.S. public equity market, especially new capital formation via initial public offerings. The number of initial public offerings in recent years has continued to decline as a result of the ongoing erosion of the competitive position of the U.S. public equity market. This loss of competitive advantage has resulted in a significant decline in capital markets activity generally, and caused seriously detrimental effects on the formation and efficient allocation of capital for emerging growth companies in particular. The recently released Interim Report of the Committee on Capital Markets Regulation (the "CCMR") found the U.S. market increasingly unable to capture initial public offerings and compete in the global marketplace, in large part due to the cost and competitive disadvantages of the regulatory process in the U.S.

Of particular concern to venture-backed companies is The Global Settlement of Conflicts of Interest Between Research and Investment Banking (the "Global Settlement") reached in April 2003, which fundamentally changed the ability of new and small companies to obtain research analyst coverage. The Global Settlement and the disincentives it created, resulted in the disappearance of research analyst coverage for small and mid-cap companies. That research coverage, formerly provided by analysts employed by the investment banks that brought such companies public, was critical to attracting sufficient interest and investment from institutional capital, without which such companies could not survive. Combined with the skyrocketing costs imposed on newly-public companies by Sarbanes-Oxley, the IPO window for venture-backed companies essentially closed.

The NVCA fully supports a regulatory framework that strikes a proper balance between investor protection and market integrity on the one hand and the cost, burden and intrusion imposed on market participants on the other. We further recognize that FINRA is part of a larger overall regulatory framework that must operate within a broader market context.

Thank you for the opportunity to comment on Notice 08-55. Please feel free to contact Ettore A. Santucci at 617-570-1531, William J. Schnoor at 617-570-1020 or Eric J. Graham at 617-570-1006 if we can be of any further assistance.

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Sincerely,

Goodwin Procter LLP

GOODWIN PROCTER LLP

cc: Mark G. Heesen, President
National Venture Capital Association

Please accept this in response to FINRA requests for Comment on Proposed Research Registration and Conflict of Interest Rules contained in Regulatory Notice 08-55

Proposed FINRA Rule 1223 is a step in the right direction by easing the requirement to pass the Series 86 exam so that only those associated persons "whose primary job function is to provide investment research" (combined with other criteria such as also passing the Series 87 exam) are required to pass it. However, the Series 86 exam as now designed should be eliminated in its entirety or revised to only test for knowledge of the regulations dealing with conflicts of interest and personal bias. The Series 86 exam is much too difficult - some say it is harder than bar exams and accountancy exams and on a par with one of the most difficult professional exams of all, the CFA.

I believe that part of the current economic crisis facing the U.S. is the result of analysts not identifying the risks inherent in derivative instruments. This failure is a result of over reliance on the traditional modeling and valuation techniques in the investment community. Of the five sections of the current Series 86 exam, four test "Analysis, Modeling and Valuation" in various applications and one section tests information and data collection.

Also, this emphasis on metrics and forecasting based on past performance has little to do with the thousands of smaller listed companies that have short operating histories and need research coverage. The Series 86 exam shows a bias in favor of analysts who cover large capitalized companies with several years of operating history. Some analysts are interested in covering smaller companies who do not have years of operating history. These analysts have no interest in taking the time and expending resources to memorize dozens of forecasting metrics, mathematical models and formulae that they are required to master in order to pass the Series 86 exam. In addition, the Series 86 exam virtually ignores non-data driven approaches to stock market analysis that may be better than the modeling and valuation techniques tested by the Series 86 exam and, if more widely used, could have prevented the current economic crisis. One such ignored approach is known by economists as behavioral economics or behavioral finance. This approach recognizes that data does not always rule and that often markets are imperfect because they are driven by factors other than metrics such as sociological and psychological factors.

In addition, I believe that the current Series 86 exam prerequisite is governmental action that unnecessarily restricts a citizen's right to comment on the stock market, individual companies and their management and could be ripe for challenge on first amendment constitutional grounds.

Finally, in practice it is extremely difficult for FINRA members to comply with the myriad of regulations impacting communications with the public by a broker-dealer. The current definitions contained in FINRA Rule 2240 and Rule 2210 are sometimes tautological and define by negative reference. For example, the term "Research Report" in Rule 2240(a)(10) in the first paragraph gives a basic, short definition but then states: "The term does not include: . . ." and lists five categories as definitional carve-outs under subparagraph (A), three categories under subsection (B) and one category under subsection (C). To add to the confusion, Rule 2210(a) states that "communications with the public: consist of . . ." and then sets forth six broad categories that sometimes cross-reference each other. Often, it is very difficult for securities attorneys and compliance professionals to determine whether material is an "advertisement" under the definition contained in Rule 2210(a)(1) or "sales literature" as that term is defined in Rule 2210(a)(2). A large part of this confusion is the result of the definition of "sales literature" beginning this way: "Any written or electronic communication, *other than an advertisement . . .* (italics mine)." In a close-call as to whether particular material is advertising versus sales literature, this tautological drafting device makes a definitional comparison impossible. More confusion results because as the rules are now drafted sometimes the media used to disseminate material, as opposed to the content of the material, determines its communication status and the regulations that apply. FINRA should issue clear and workable definitions of "communications with the public," please.

In conclusion, FINRA should encourage, not discourage, market transparency by easing the overly burdensome restrictions on broker-dealers, especially smaller broker-dealers, who desire to issue research reports. Specifically, the Series 86 exam prerequisite should be eliminated or the exam should be redesigned. It is one thing to test analysts regarding their obligations to avoid conflicts of interests and to voice their true opinions. However, FINRA should not be the arbiter of determining which world view of the market is the correct one.

Respectfully submitted,
Daniel H. Kolber,
Atlanta, Georgia
24, 27, 87, 4, 53, 54, 7, 63, 65 FINRA Licenses,
Member of Georgia, New York, Florida, and Virginia Bars

Exhibit 3

**Joint Report by NASD and the NYSE
On the Operation and Effectiveness of the
Research Analyst Conflict of Interest Rules**

December 2005

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EXHIBITS

Exhibit A – SRO Rules

NYSE Rules 472 and 472(k) Interpretation, 351, 344 and 344 Interpretation, and 345A

NASD Rules 2711, 1050 and 1120

Exhibit B – July 2002 Joint Memorandum

NYSE Information Memo No. 02-26 (June 26, 2002) and NASD *Notice to Members* 02-39 (July 2002)

Exhibit C – March 2004 Joint Memorandum

NYSE Information Memo No. 04-10 (Mar. 9, 2004) and NASD *Notice to Members* 04-18 (Mar. 2004)

Exhibit D – Chart Comparing SRO Rules and Global Settlement

INTRODUCTION

Beginning in 2002, the New York Stock Exchange (“NYSE”) and NASD (together, “the SROs”) implemented a series of rule changes (“SRO Rules”) to improve objectivity and transparency in equity research and provide investors with more reliable and useful information to make investment decisions. The rules were intended to restore public confidence in the validity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities. The trustworthiness of research had eroded due to the pervasive influences of investment banking and other conflicts that had manifest themselves during the market boom of the late 1990s.

Generally, the SRO Rules require clear, comprehensive and prominent disclosure of conflicts of interest in research reports and public appearances by research analysts. The rules further prohibit certain conduct – investment banking personnel involvement in the content of research and determination of analyst compensation, for example – where the conflicts are considered too pronounced to be cured by mere disclosure. Together with the Securities and Exchange Commission’s (“SEC” or the “Commission”) Regulation Analyst Certification and the settlement terms of certain enforcement proceedings, including the “Global Settlement” among the SROs, the Commission, the North American Securities Administrators Association (“NASAA”) and ten¹ of the largest investment banks, the SRO Rules have resulted in sweeping changes to the way firms produce research, utilize and compensate research analysts, and structure the operations of their research and investment banking departments. Evidence suggests that these reforms have resulted in more objective, reliable and valuable research for investors. However, the new rules also have added costs and administrative burdens to firms and contributed to a reduction in research coverage and analyst compensation.

The SEC has requested that the SROs submit this joint report on the operation and effectiveness of the SRO Rules, including any staff recommended changes to the current rule provisions.² The report contains six sections. Section I provides background on the conflicts that gave rise to the SRO Rules and sets forth the history of the SRO rulemaking and other regulatory initiatives with respect to research-related activity. Section II discusses the registration and qualification requirements for research analysts and their supervisors, including statistics concerning the levels of registration and qualification. Section III contains a review of SRO examinations, sweeps and enforcement activity since the SRO Rules became effective. Section IV discusses the impact of the SRO Rules as reported in academic studies and media reports and commentary. Section V contains a detailed review of the SRO Rule provisions, including member feedback and recommended changes. Finally, Section VI is the Conclusion.

¹ In August 2004, two additional firms settled with regulators under the same terms as the April 2003 Global Settlement.

² The views provided in this report are solely those of the NASD and NYSE staffs and have not been endorsed by the Board of Governors of NASD or the Board of Directors of the NYSE.

I. BACKGROUND

A. Conflicts that Led to Regulation

Prior to implementation of the SRO Rules, research analysts were subject to a host of pressures and influences that could – and in many instances, did – compromise the objectivity of their research. The primary biasing forces came from investment bankers who pressured research analysts to speak favorably of current and prospective clients and, with management acquiescence, linked analysts' compensation directly to their role in landing lucrative investment banking deals. In the succinct words of a retired Wall Street research analyst who testified before Congress in the summer of 2001: "Investment banking now dominates equity research."³ Other conflicts also existed, most notably analysts' personal financial interest in the securities they covered and their firms' ownership positions in covered securities. In addition, research analysts were subject to pressure from subject companies and their major shareholders to maintain favorable ratings.⁴

In testimony before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (the "Subcommittee"), SEC Acting Chair Laura Unger identified a number of then commonplace practices that illustrated the conflicts of interest faced by research analysts.⁵ First, research analysts were compensated based on their contributions in support of investment banking transactions and the profitability of that unit. To that end, research analysts typically consulted on possible transactions, participated in road shows and initiated favorable coverage on current and prospective investment banking clients. Moreover, investment bankers at some firms evaluated research analysts for compensation purposes, particularly bonuses.

Second, research analysts provided research reports on companies underwritten by the analysts' firms. Third, research analysts invested in pre-initial public offering ("IPO") private placements of companies they subsequently covered and for which their firms had acted as underwriters. Fourth, research analysts provided investment bankers with prior notice of changes in recommendations. Fifth, research analysts issued "booster-shot" research reports or "buy" recommendations close to expiration of the lock-up period. Such reports served to generate buying interest in the stock and help increase the price while the firm, its clients, or the analysts sold their shares. Sixth, research analysts owned securities in the companies they covered and either failed to disclose those interests or did so in an opaque manner. In some cases, analysts executed trades for their personal accounts that were contrary to the recommendations in their research reports.⁶ Finally, analysts rarely revealed any conflicts of interest to investors during

³ *Analyzing the Analysts: Hearings Before the H. Comm. On Capital Markets, Insurance, and Government Sponsored Enterprises of the Comm. On Financial Services*, 107th Cong., at 243 (2001) (prepared testimony of Ronald Glantz, retired) ("Glantz Testimony").

⁴ *See, e.g., Analyzing the Analysts* at 251 (prepared testimony of Charles L. Hill, Director of Financial Research, Thomson Financial/First Call) ("analyst objectivity is subject to pressure from four different places": (1) analysts themselves; (2) investment banking; (3) public companies; and (4) institutional shareholders).

⁵ *Analyzing the Analysts* at 227-240 (written testimony of Laura S. Unger, Acting Chair of the Securities and Exchange Commission) ("Unger Testimony").

⁶ *Id.* at 233. *See also, e.g., Analyzing the Analysts* at 160 (prepared testimony of Gregg Hymowitz, Founder and Principal of EnTrust Capital Inc.); Glantz Testimony, *supra* note 3; *Analyzing the Analysts* at 266

media appearances in which they routinely recommended securities, and while most firms affirmatively stated that they acted as an underwriter or market maker, others merely stated that they “may” have acted in that capacity.⁷

While these conflicts were not new, they had deepened in the existing market environment. As another witness who testified before the Subcommittee observed:

[T]he pressures on the analyst have escalated in an environment where penny changes in earnings-per-share forecasts make dramatic differences in share price, where profits from investment-banking activities outpace profits from brokerage and research, where the demographics of the investors who use and rely on sell-side research have shifted, and where investment research and recommendations are now prime-time news.⁸

The industry itself seemed to recognize that the conflicts in research had intensified. As the SROs began rulemaking, discussed in Section I.B below, the industry took steps on its own to address these conflicts. Several firms amended or adopted policies regarding research analysts’ ownership of securities of covered companies.⁹

In addition, in June 2001, the Securities Industry Association (“SIA”) endorsed a compilation of “best practices”¹⁰ designed to restore the integrity of research and “reaffirm that the securities analyst serves only one master: The investor.”¹¹ The practices were compiled by an ad hoc committee of senior research professionals from the SIA’s largest member firms, and included several key recommendations focused on analyst compensation and stock ownership, relations

(prepared testimony of Adam Lashinsky, Silicon Valley Columnist, The Street.com); *Id.* at 253 (prepared testimony of Matt Winkler, Editor-in-Chief, Bloomberg News).

⁷ Unger Testimony, *supra* note 5, at 234.

⁸ *Analyzing the Analysts* at 196 (statement of Thomas A. Bowman, CFA, President and Chief Executive Officer, The Association for Investment Management and Research).

⁹ For example, Merrill Lynch, Edward Jones and Credit Suisse First Boston announced new policies prohibiting analysts from owning shares in companies they follow. *See id.* at 120 (opening statement of Honorable Paul Kanjorski). Goldman Sachs initiated a policy that would permit analysts to own shares in companies they cover under the following conditions: (1) approval of management and the firm’s compliance committee would be required for purchases; (2) purchases would be subject to a minimum 30-day holding period; (3) analysts would be permitted to purchase only stocks that were rated a “trading buy” or already on the firm’s recommended list; (4) analysts would be prohibited from selling securities unless they were rated below a “trading buy”; and (5) there would be a twenty-four hour restriction imposed after a change in the rating of a company. *See Adam Lashinsky, Wall Street’s Discovery of Ethics Is Too Little, Too Late*, TheStreet.com, July 10, 2001, <http://www.thestreet.com/markets/adamlashinsky/1486552.html>.

Prior to this time, Robertson Stephens had implemented a policy in September 2000 pursuant to which: (1) analysts cannot own stock in companies they cover, and (2) if they already own shares in a company they want to cover, they are required to sell their shares or place them in a blind trust. *Id.*

¹⁰ *See Best Practices for Research*, June 2001, and Press Release, *SIA Endorses “Best Practices” To Ensure Ongoing Integrity of Research* (June 21, 2001); *Analyzing the Analysts* at 172 (statement of Marc E. Lackritz, President, SIA).

¹¹ *See Best Practices for Research*, June 2001, and Press Release, *supra* note 10.

with investment banking units and disclosures: (1) research departments should not report to investment banking or any other business units that might compromise their independence, and there should be no outside or investment banking approval of the analyst's opinions or recommendations; (2) analysts' compensation should not be directly linked to specific investment banking transactions, sales and trading revenues or asset management fees; (3) personal financial interests in covered securities should be disclosed; and (4) analysts should not trade contrary to their recommendations, except after consultation with research department, legal and/or compliance personnel.¹²

Similarly, in July 2001, the Association for Investment Management and Research ("AIMR"), which is now named the CFA Institute, released a white paper discussing a wide range of potential influences on the objectivity of brokerage-firm research.¹³ The white paper also set forth recommendations for a more objective research environment, including: (1) brokerage firm management must foster a corporate culture that fully supports independence and objectivity; (2) firms must establish or reinforce separate reporting structures so that investment banking can never influence a research report or investment recommendation; (3) firms should implement compensation arrangements that do not link analysts' compensation to investment banking work; and (4) firms should require public disclosure of actual conflicts of interest to investors.¹⁴

However, the guidelines set forth by the industry associations lacked the force and effect of law. Moreover, some lawmakers felt the voluntary industry efforts were inadequate in scope. As Congressman Richard Baker remarked on the second day of hearings before the Subcommittee, "[T]he existing industry association best-practices proposal doesn't go far enough to address the problems, nor, I might add, do subsequent actions taken by individual firms"¹⁵ Congressman John LaFalce expressed that "more disclosure of these conflicts, in itself will not suffice to protect the individual investor."¹⁶

B. Summary of Rule Filings and Other Regulatory Actions

1. NASD/NYSE Rule Filings

The SROs enacted the research analyst conflict rules in two primary tranches and, more recently, adopted additional amendments prohibiting analysts from participating in road shows. *See* Exhibit A for the complete text of the SRO Rules. In addition, the SROs supplemented their rulemaking with two joint memoranda that provided interpretive guidance to their members on a number of issues. *See* Exhibits B and C for the joint interpretive memoranda. The NASD and NYSE rules and interpretations are virtually identical and are intended to operate uniformly.

¹² *Id.*

¹³ *See Preserving The Integrity of Research*, Association for Investment Management and Research (July 2001), and CFA Institute Press Release, *Global Investment Association AIMR Issues Report On Analyst Objectivity* (July 11, 2001).

¹⁴ *Id.*

¹⁵ *Analyzing the Analysts* at 210 (opening statement of Honorable Richard H. Baker, Chairman).

¹⁶ *Id.* at 219 (statement of Honorable John J. LaFalce, Ranking Committee Member).

Round 1 Amendments

In February 2002, the SROs filed the first round of proposed SRO Rules (“Round 1 Amendments”) – amendments to NYSE Rules 351 (“Reporting Requirements”) and 472 (“Communications with the Public”) and new NASD Rule 2711 (“Research Analysts and Research Reports”)¹⁷ – which implemented basic reforms to separate research from investment banking and to provide more extensive disclosure of conflicts of interest in research reports and public appearances.

Generally, the Round 1 Amendments, approved by the SEC on May 10, 2002,¹⁸ achieved the following:

- imposed structural reforms to increase analyst independence, including prohibiting investment banking personnel from supervising analysts or approving research reports;
- prohibited offering favorable research to induce investment banking business;
- prohibited research analysts from receiving compensation based on a specific investment banking transaction;
- required disclosure of financial interests in covered companies by the analyst and the firm;
- required disclosure of existing and potential investment banking relationships with subject companies;
- imposed quiet periods for the issuance of research reports after securities offerings managed or co-managed by a member;
- restricted personal trading by analysts;
- required disclosure in research reports of data and price charts that help investors track the correlation between an analyst’s rating and the stock’s price movements; and
- required disclosure in research reports of the distribution of buy/hold/sell ratings and the percentage of investment banking clients in each category.

The Round 1 Amendments were phased-in incrementally to provide members time to implement necessary policies, procedures, systems and other measures to comply with the new

¹⁷ On February 8, 2002, NASD filed SR-NASD-2002-021. The NYSE filed SR-NYSE-2002-09 on February 27, 2002. On March 7, 2002, NASD filed Amendment No. 1 to SR-NASD-2002-021. The proposals were published for comment in the Federal Register on March 14, 2002. *See* Securities Exchange Act Release No. 45526 (Mar. 8, 2002), 67 FR 11526 (Mar. 14, 2002). On May 1, 2002, NASD filed Amendment No. 2 to SR-NASD-2002-021, and the NYSE filed Amendment No. 1 to SR-NYSE-2002-09.

¹⁸ *See* Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) (order approving SR-NYSE-2002-09 and SR-NASD-2002-021).

requirements. Most provisions of the SRO Rules went into effect on July 9, 2002; others became effective on September 9, 2002 or November 6, 2002.¹⁹

Round 2 Amendments and Sarbanes-Oxley

On July 29, 2003, the SEC approved a second set of amendments to the SRO Rules (“Round 2 Amendments”)²⁰ that achieved two purposes. First, the Round 2 Amendments implemented SRO initiatives to further promote analyst objectivity and transparency of conflicts in research reports. The need for some of these additional measures had come to light in the course of joint sweeps undertaken by the SROs and SEC to examine members’ research practices for compliance with industry regulations.²¹ Among the most significant SRO initiatives included in the Round 2 Amendments were provisions that:

- further insulated analyst compensation from investment banking influence by requiring that a compensation committee, without investment banking representation, review and approve compensation of research analysts and that such compensation be based on the quality of research produced;
- prohibited analysts from participating in the solicitation of investment banking business;
- prohibited analysts from issuing a research report or making a public appearance concerning a subject company around the time of a lock-up expiration, termination or waiver;
- required members to publish a final research report when they terminate coverage of a subject company and provide notice of such termination;
- imposed registration, qualification and continuing education requirements on research analysts (detailed in Section II below); and
- created an exemption from certain rule provisions for firms that engage in limited underwriting activity.

Second, the Round 2 Amendments implemented changes mandated by the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”).²² Sarbanes-Oxley required adoption by July 30, 2003 of rules “reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances,” and set forth certain specific rules to be promulgated. Many of those rules had already been adopted in the first round

¹⁹ Certain small firms with limited underwriting activity were granted delayed effectiveness from certain provisions of the SRO Rules until July 2003, at which time a limited exemption was adopted and codified.

²⁰ Securities Exchange Act Release No. 48252 (July 29, 2003), 68 FR 45875 (Aug. 4, 2003) (order approving SR-NYSE-2002-49 and SR-NASD-2002-154).

²¹ In April 2002, the SROs and the SEC established a Joint Task Force to review practices of designated firms with regard to research reports and recommendations on issuers for which firms had provided or sought investment banking services from January 1999 through April 2002.

²² See Section 15D(a) of the Exchange Act, 15 U.S.C. 78o-6.

of SRO rulemaking. The Round 2 Amendments therefore implemented those specific Sarbanes-Oxley rules that did not already exist and conformed the language of the SRO Rules as necessary. Most notably, the Round 2 Amendments satisfied the following Sarbanes-Oxley requirements:

- modified the definition of “research report” to delete the requirement that the communication contain a recommendation;
- extended quiet periods after securities offerings to all firms that participated in the offering as an underwriter or dealer;
- required disclosure of a client relationship and non-investment banking compensation received by a firm from a covered company; and
- prohibited retaliation against research analysts for publishing unfavorable research on an investment banking client.

As with the Round 1 Amendments, the Round 2 Amendments were phased-in incrementally. Most provisions went into effect on September 29, 2003, while certain other provisions did not become effective until October 27, 2003 or January 26, 2004.²³

Recent Amendment Prohibiting Analyst Participation in Road Shows

On April 21, 2005, the Commission approved an amendment to the SRO Rules that prohibits research analysts from participating in a road show related to an investment banking services transaction and from communicating with current or prospective customers in the presence of investment banking department personnel or company management about such an investment banking services transaction.²⁴ Additionally, the amendment prohibits investment banking personnel from directing a research analyst to engage in sales and marketing efforts and other communications with a current or prospective customer about an investment banking services transaction.

By prohibiting research analysts from participating in road shows and communicating with customers in the presence of investment bankers or company management, the amendment further reduces pressure on research analysts to give an overly optimistic assessment of a particular transaction. It also removes any suggestion to investors in attendance at a road show that the analyst will give positive coverage to the issuer or that the analyst endorses all of the views expressed by the company or investment banking department personnel.

²³ In 2004, the SROs delayed the effectiveness of certain disclosure provisions in the rules until April 26, 2004. See Securities Exchange Act Release No. 49119 (Jan. 23, 2004), 69 FR 4337 (Jan. 29, 2004) (notice of immediate effectiveness of SR-NASD-2004-003 and SR-NYSE-2004-01).

²⁴ Securities Exchange Act Release No. 51593 (Apr. 21, 2005), 70 FR 22168 (Apr. 28, 2005) (order approving SR-NASD-2004-141 and SR-NYSE-2005-24). As defined under NASD Rule 2711(a)(2) and NYSE Rule 472.20, “investment banking services” includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

The amendment expressly permits research analysts to educate investors and member personnel about a particular offering or other transaction, provided the communication occurs outside the presence of company management and investment banking department personnel. Such permissible communications to investors and internal personnel must be fair, balanced and not misleading, taking into account the overall context in which such communications are made.²⁵

The amendment became effective on June 6, 2005.

2. Joint Memoranda and Interpretations

The Commission noted in its approval order of May 10, 2002 that the SROs would provide interpretive guidance on certain provisions of the SRO Rules. Accordingly, contemporaneous with the first effective date of the new rules, the SROs issued a joint memorandum (“July 2002 Joint Memorandum”) providing interpretive guidance on a number of topics, including: the definitions of “investment banking services” and “research report”; public appearances; quiet periods; the applicability of the SRO Rules to third-party research; the prohibition on certain forms of research analyst compensation; restrictions on personal trading by analysts; and requisite disclosures, including the distribution of ratings and price charts (*see* Exhibit B).²⁶

In March 2004, the SROs issued a second joint memorandum (“March 2004 Joint Memorandum”) to provide further interpretive guidance on the amended SRO Rules (*see* Exhibit C).²⁷ That memorandum generally addressed issues related to the definition of “research report”; the applicability of the “gatekeeper,” blackout and quiet periods provisions; and the scope and prominence of certain disclosure requirements.

The SROs continue to work together on interpretive issues.

3. Other Regulatory Initiatives

Regulation AC

On February 6, 2003, the SEC adopted Regulation Analyst Certification (“Regulation AC”), which took effect on April 14, 2003.²⁸ Regulation AC generally requires broker-dealers to include in a research report certifications by the analysts who are principally responsible for

²⁵ The prohibition on research analysts’ participation in road shows does not prohibit certain analysts’ communications that are permitted under the federal securities laws. *See* 17 CFR 230.137, 230.138 and 230.139 (research reports issued in accordance with Rules 137, 138 and 139 under the Securities Act of 1933).

²⁶ *See* NYSE Information Memo No. 02-26 (June 26, 2002), and NASD *Notice to Members* 02-39 (July 2002).

²⁷ *See* NYSE Information Memo No. 04-10 (Mar. 9, 2004), and NASD *Notice to Members* 04-18 (Mar. 2004).

²⁸ *See* Regulation Analyst Certification, Securities Exchange Act Release No. 47384 (Feb. 20, 2003), 68 FR 9482 (Feb. 27, 2003). In August 2003 and April 2005, the SEC staff issued additional guidance regarding Regulation AC in a series of questions and answers on the SEC Web site. *See* SEC Responses to Frequently Asked Questions Concerning Regulation Analyst Certification, <http://www.sec.gov/divisions/marketreg/mregacfaq0803.htm>.

preparing the report (1) that the recommendations or views expressed in the research report accurately reflect the analysts' personal views about the subject securities and issuers, and (2) whether any part of the analysts' compensation was, is, or will be directly or indirectly related to any specific recommendations or views expressed in the research report. In addition, research analysts must certify to the accuracy of statements made in public appearances and that no part of the research analysts' compensation is tied to statements made during the public appearance. If the broker-dealer does not obtain such certification by the analysts, it must disclose this fact and promptly notify its designated examining authority. The SROs continue to examine for compliance with Regulation AC.

Unlike the SRO Rules, Regulation AC applies to both fixed-income and equity research reports and the analysts who are primarily responsible for preparing those reports. Similar to the SRO Rules, Regulation AC broadly defines a "research report" as "a written communication (including an electronic communication) that includes an analysis of a security or an issuer and provides information reasonably sufficient upon which to base an investment decision."

4. Enforcement Proceedings

As the SROs engaged in rulemaking to manage and eradicate existing research conflicts, regulators brought enforcement proceedings to redress past misconduct in the area.

Merrill Lynch Settlement

In May 2002, as part of a settlement with the New York Attorney General, Merrill Lynch agreed to adopt certain changes to its equity research and investment banking activities. Among other things, Merrill Lynch agreed to completely separate analyst compensation from investment banking, prohibit investment banking input into analysts' compensation and disclose in all research reports whether it has received or is entitled to receive any compensation from a covered company over the past 12 months.

The Global Settlement

On April 28, 2003, the SEC, NYSE, NASD, NASAA and the New York Attorney General's Office announced that they had reached an agreement (the "Global Settlement") with ten investment banking firms settling actions alleging fraudulent or misleading research. The United States District Court for the Southern District of New York approved the Global Settlement on October 31, 2003²⁹ and an amendment to the agreement was approved in September 2004.³⁰

The Global Settlement differs in structure from the SRO Rules. The former generally prohibits all communications between research and investment banking personnel, with certain express exceptions. In contrast, the SRO Rules permit all communications that are not expressly prohibited. But the key provisions of the Global Settlement and the SRO Rules are essentially

²⁹ See SEC Litigation Release No. 18438, 2003 SEC LEXIS 2601 (Oct. 31, 2003).

³⁰ See 03 Civ. 2941 (WHP), 2004 U.S. Dist. LEXIS 19149 (S.D.N.Y. Sept. 24, 2004) (amendments to Addendum A).

the same; the few differences are noted below. A chart comparing the provisions is included as Exhibit D.

The common provisions include prohibitions on review and approval of research by investment banking; prohibitions on research analysts from soliciting investment banking business and participating in sales and marketing activities; requirements for the termination of coverage; general requirements that the compensation of a research analyst primarily responsible for the preparation of the substance of a research report be reviewed and approved by a member firm committee without investment banking representation that reports to the Board of Directors or the senior chief executive officer; and increased disclosure and transparency of potential and actual conflicts of interests and of issues related to the performance of research analysts, such as ratings, price targets and an explanation of the firm's rating system.

Some Global Settlement terms have not been explicitly or implicitly incorporated into the SRO Rules. For example, the Global Settlement requires that the work of the compensation committee be reviewed by an oversight committee of research management. Other Global Settlement requirements not incorporated by the SROs are physical separation between research analysts and investment banking; the requirement that research have its own dedicated legal and compliance staff; and requirements for firms to procure and make available for their clients independent research on listed companies that they cover.

Additionally, comparable SRO Rules and Global Settlement definitions differ in degree and scope. The definitions of "research reports" and "research analysts" are illustrative. The SRO Rules, for example, apply to all research reports produced by the SROs' members, irrespective of where or to whom they are distributed; however, the Global Settlement limits its definition of "research report" to communications furnished to investors in the United States. Also, the SRO Rules' definition of "research analyst" – the same as mandated by the Sarbanes-Oxley Act – is broader than the Global Settlement's definition of "Research Personnel," which is limited to those individuals whose primary job is the preparation of research reports.

The SRO staffs address in Section V whether they recommend incorporating additional Global Settlement terms into the SRO Rules or making any other conforming changes.

II. REGISTRATION AND QUALIFICATION REQUIREMENTS

A. Series 86/87 Examinations

As part of the Round 2 Amendments, the SEC approved rules requiring registration and qualification requirements for research analysts. The SRO Rules require an associated person³¹ who functions as a research analyst on behalf of a member to register as such and pass a qualification examination. Those rules are intended to ensure that research analysts possess a certain competency level to perform their jobs effectively and in accordance with applicable rules and regulations. In the context of this requirement, the SRO Rules define "research analyst" as "an associated person who is primarily responsible for the preparation of the

³¹ See SR-NYSE-2005-24 amending the definition of "research analyst" in NYSE Rules 344.10 and 472.40 to include "associated persons." NASD rules already separately defined "associated person."

substance of a research report or whose name appears on a ‘research report,’” as that term is defined in the SRO Rules.

The SROs jointly developed and implemented the Research Analyst Qualification Examination (Series 86/87). The examination consists of an analysis part (Series 86) and a regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate also must have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative Examination (Series 17), or the Canada Module of Series 7 (Series 37 or 38). Persons who were functioning as research analysts on the effective date of March 30, 2004 and submitted a registration application to NASD by June 1, 2004, had until April 4, 2005 to meet the registration requirements. There was no grandfather provision. The one-year grace period was intended to provide these analysts sufficient time to study and pass the examination without causing undue disruption in carrying out their responsibilities to their member firm and its customers.

B. Exemptions

The SRO Rules provide three exemptions from the Series 86 examination. First, there is an exemption for research analysts who have passed Levels I and II of the Chartered Financial Analyst (“CFA”) examination and have either (1) completed the CFA Level II within 2 years of application or registration, or (2) functioned as a research analyst continuously since having passed the CFA Level II.³² A second exemption is available to research analysts who have passed Levels I and II of the Chartered Market Technician Examination and produce only “technical research reports” as that term is defined under the SRO Rules.³³

A third exemption – from both the Series 86 and Series 87 – is available to “associated persons” of a member who are employed by that member’s foreign affiliate but who produce research on behalf of the U.S. member. The SROs created this third exemption in response to requests from some members with global research operations that had difficulty ascertaining whether certain foreign research analysts whose work contributed to the member’s research report were “associated persons” who must meet the registration and qualification requirements under the SRO Rules.

To be eligible for the exemption, three primary conditions must be met: (1) a foreign analyst must comply with the registration and qualification requirements or other standards in an SRO-approved foreign jurisdiction whose regulatory scheme reflects a recognition of principles that are consonant with the SRO Rules and qualification standards; (2) the U.S. member must apply all of the other SROs rules and other member firm standards to the research produced by the foreign affiliate and foreign research analysts that qualify for, and rely upon, the exemption; and (3) the U.S. member must include a specific disclosure that the research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member who are not registered/qualified as a research analyst with the NYSE or NASD, but instead have

³² See Securities Exchange Act Release No. 49464 (Mar. 24, 2004), 69 FR 16628 (Mar. 30, 2004) (order approving SR-NYSE-2004-03 and SR-NASD-2004-020).

³³ See Securities Exchange Act Release No. 51240 (Feb. 23, 2005), 70 FR 10451 (Mar. 3, 2005) (notice of immediate effectiveness of SR-NYSE-2005-12 and SR-NASD-2005-022).

satisfied the registration/qualification requirements or other research-related standards of a foreign jurisdiction that have been recognized for these purposes by the NYSE and NASD.

Eligibility for the exemption in no way bears upon whether the foreign research analyst is an associated person of the member. And to the extent that a member can determine that a foreign research analyst is *not* an “associated person,” there is no requirement to satisfy any of the SRO Rules, including the registration and qualification requirements.

Currently, the following jurisdictions satisfy the applicable SRO standards noted above: China, Hong Kong, Japan, Malaysia, Singapore, Thailand and the United Kingdom. The SROs only considered those jurisdictions submitted by the members that requested the exemption but agreed to consider additional jurisdictions on a case-by-case basis, as requested.³⁴

C. Supervisory Requirements

NASD has an additional rule that requires supervisors of research analysts to pass the Series 87 examination or the NYSE Series 16 Supervisory Analyst Examination. Those who oversee the *content* of research reports must have passed either the Series 87 or the Series 16 examination. A registered principal (Series 24) who has also passed either the Series 87 or the Series 16 examination must supervise the conduct of both the Series 16 Supervisory Analyst and the research analyst. The rule became effective on August 2, 2005.³⁵ NYSE Rule 472(a)(2) requires that a supervisory analyst acceptable under NYSE Rule 344 approve research reports.

D. Statistics

Between April 1, 2004 and November 30, 2005, 5,599 research analysts and 418 research principals had satisfied the applicable registration and qualification requirements. The Series 86 exam was attempted 6,158 times, with an overall pass rate of 74.9%, and the Series 87 exam was attempted 8,259 times, with an overall pass rate of 89.6%. During the same period, 2,375 CFA exemptions and 34 technical analyst exemptions were granted.

III. EXAMINATIONS, SWEEPS AND ENFORCEMENT ACTIONS

The SROs continue to closely examine for compliance with the SRO Rules and rigorously pursue enforcement actions for violations of these rules. The area of research analyst conflicts remains a high priority component of the SROs’ examination and enforcement programs.

A. NASD Summary

1. Member Regulation

As the SRO Rules became effective, NASD’s Member Regulation Department incorporated into its routine examination program an inspection for compliance with NASD Rule 2711 and SEC Regulation AC.

³⁴ The SROs will notify their membership in the event additional jurisdictions are approved.

³⁵ Securities Exchange Act Release No. 50162 (Aug. 6, 2004), 69 FR 50406 (Aug. 16, 2004) (order approving SR-NASD-2004-078).

Between July 2002 and November 30, 2005, NASD initiated 467 examinations reviewing firms for compliance with Rule 2711 and Regulation AC. In the course of these examinations, NASD found 110 violations of Rule 2711 and 25 violations of Regulation AC. Specifically, the Rule 2711 violations have involved: (1) failure to have adequate procedures in place to supervise the activities of research analysts with respect to conflicts of interest, in violation of Rule 2711(i) (47 of 467 examinations); (2) failure to adequately comply with the disclosure requirements regarding research reports and public appearances, in violation of Rule 2711(h) (24 of 467 examinations); (3) failure to file the Annual Attestation, in violation of Rule 2711(i) (20 of 467 examinations); (4) personal trading of the subject companies' securities in the analyst's account within the restricted time period, in violation of Rule 2711(g) (10 of 467 examinations); and (5) failure to comply with restrictions on communications with the subject company, in violation of Rule 2711(c) (9 of 467 examinations).

Of the 135 violations of Rule 2711 and Regulation AC found to date, 27 have resulted or are expected to result in an Acceptance, Waiver and Consent, seven have resulted in a formal complaint, 18 have resulted in a compliance conference, 81 have resulted in a Letter of Caution, and two remain under investigation.

2. Enforcement

As of November 30, 2005, NASD Enforcement has settled 29 cases involving Rule 2711 violations and two cases involving violations of Rule 1050, the analyst registration rule. By far, the vast majority of settled Enforcement actions have involved violations of the disclosure requirements of Rule 2711(h), encompassing over 265 research reports. Specific violations of this provision include: (1) failure to disclose ownership of shares of subject companies; (2) failure to disclose compensation for investment banking services from the subject company; (3) failure to disclose market making activity; (4) use of conditional language in making the requisite disclosures; (5) failure to provide sufficient price charts; (6) failure to disclose the distribution of buy, hold and sell recommendations; (7) failure to provide information about the valuation methods used; (8) failure to define recommendations; and (9) failure to provide disclosures required by Rule 2210.

Other settled Enforcement cases have involved such violations of Rule 2711 as (1) failure to maintain supervisory procedures pursuant to Rule 2711(i) (113 research reports); (2) communications with subject companies in violation of Rule 2711(c) (17 research reports); and (3) failure to abide by the personal trading restrictions under Rule 2711(g) (21 research reports). In addition, two cases involved analysts offering favorable research reports in exchange for compensation in violation of Rule 2711(e), and one case involved a firm's failure to provide notice of termination of coverage and issue final research reports with respect to seven subject companies, in violation of Rule 2711(f).

Sanctions in the settled Enforcement cases have included fines ranging from \$10,000 to \$50,000, disgorgement, suspensions and bars in all capacities. In addition, NASD Enforcement has settled with two firms for failure to timely apply for research analyst designation in violation of Rule 1050. These two cases involved 56 analysts and 325 research reports, and each firm was censured and fined (one in the amount of \$100,000; the other, \$150,000).

There are currently two pending complaints against firms and a number of open investigations involving suspected violations of Rule 2711. These matters involve many of the same compliance issues discussed above, including allegations of failure to meet disclosure obligations and of transgressing the personal trading restrictions. In addition, in summer 2005, the SROs launched a joint sweep of 30 firms to review their compliance with NASD Rules 2711 and 1050 and NYSE Rule 344 in the context of research prepared on behalf of the members by foreign analysts. That review is ongoing.

3. Advertising

Although members need not file research reports with NASD's Advertising Regulation Department, they do constitute "communications with the public" under NASD's advertising rules. As such, NASD's Advertising Regulation Department has conducted two sweeps since NASD Rule 2711 was implemented. In 2002, a sweep of 28 firms was conducted to determine whether firms had made a good faith effort to comply with Rule 2711 and identify any new interpretive issues that might arise. Firms were notified of any compliance shortcomings, with the expectation that those deficiencies promptly would be remedied.

In 2004, NASD's Advertising Regulation Department conducted a second sweep of the ten Global Settlement firms and specifically requested information about their equity research reports (including access to their Web sites), samples of each type of report they used and explanatory material about their ratings. As part of this second sweep, examiners revisited the spot check conducted in 2002 to determine whether firms had made revisions as indicated.

This subsequent review revealed continued deficiencies in several areas. First, some firms were unclear in describing their ratings methodology. For example, some firms failed to explain a two-pronged approach they employed to assess a sector and an individual issuer within that sector. Examiners flagged such reports for failure to comply with the clarity requirement of Rule 2711(h)(10) because the absence of clear ratings descriptions could lead to misconceptions by investors about the firm's actual view of the issuer. Second, some members failed to provide clear disclosure presentations; for example, they used complex systems of footnotes inconsistently and indefinite disclosures (*e.g.*, "may conduct investment banking"). Examiners also identified such practices as violations of Rule 2711's clarity standard. Third, some members failed to use the terms "buy," "hold," and "sell" in the ratings distribution chart, as required by Rule 2711(h)(5). Finally, some members used language that seemed to disclaim responsibility for information in the report about the member firm, including required disclosures of certain conflicts.

NASD's Advertising Regulation Department does not have authority to bring formal actions against members and thus referred to NASD Enforcement those cases where it recommended that further action be considered.

B. NYSE Summary

1. Member Firm Regulation

The NYSE currently has 348 members and member organizations of which 217 are conducting a public business and/or issuing research. The NYSE incorporated the SRO Rule requirements into its exam scope for routine examinations of members and member organizations by Member Firm Regulation (“MFR”), following the effective dates of the SRO Rules in 2002 and 2003.³⁶

MFR examiners conducted a series of reviews investigating member and member organization compliance with the SRO Rules and SEC Regulation AC. Between August 2002 and October 2005, MFR conducted a total of 296 examinations.³⁷ NYSE examiners cited a total of 75 firms with a total of 271 findings for non and/or partial compliance with the SRO Rules and Regulation AC.³⁸ The findings were distributed as follows: 26 in 2002; 62 in 2003; 152 in 2004; and 31 in 2005.

Specifically, the NYSE examination findings included: (1) failure to clearly and prominently state in research reports in the proper format the disclosures required by the SRO Rules; (2) failure to adhere to the disclosure and record maintenance requirements for associated persons making public appearances; (3) failure to comply with record maintenance requirements evidencing the disclosures in connection with recommendations of securities in print media, interviews, newspaper articles or broadcasts; (4) failure to comply with restrictions on trading activities for associated persons; (5) failure to have legal or compliance personnel intermediate written communications between non-research personnel and research personnel concerning the content of research reports; (6) inclusion of price targets, rating summaries or research ratings information in a draft of a research report sent to a subject company; (7) executing changes to research reports after sending the report to a subject company without proper approval by legal and compliance; (8) allowing research analysts to work under the supervision or control of investment banking department personnel; (9) offering favorable research for business; (10) failure to maintain written procedures for compliance with the SRO Rules; and (11) failure to have a committee in place to review and approve analyst compensation.

2. Enforcement

Between August 2002 and November 2005, 13 examination findings were referred to Enforcement from MFR for SRO Rule violations.³⁹ As discussed in more detail below, many of

³⁶ Only members and member organizations that conducted a public business and/or issued research were examined for compliance with the SRO Rules.

³⁷ The breakdown of examinations was as follows: 21 firms in 2002, 85 firms in 2003, 140 firms in 2004 and 50 firms in 2005. In many instances the same firm was examined in successive years.

³⁸ Of the 271 findings, 22 involved Regulation AC. The 22 Regulation AC findings involved: failures by member organizations to maintain clear and prominent disclosures of research analyst certifications; failures to maintain records regarding public appearances of research analysts; failures to specify on the front page of reports the pages on which analyst certifications can be found; failures to have written policies and procedures to prevent inappropriate influences over research analysts; expired or missing certifications; failures with respect to terminated coverage; and missing attestations.

³⁹ There were also referrals based on findings for Rule 472 prior to its amendment.

these findings are currently the subject of NYSE Enforcement investigation/action, and many have been completed. Recently, a Hearing Panel Decision (“HPD”)⁴⁰ announced a disciplinary action involving violations of the SRO Rules gatekeeper provisions.⁴¹ This case resulted in consent to censure and a \$150,000 fine. Additionally, a member organization has recently consented in a Stipulation of Facts and Consent to Penalty to a fine of \$1.5 million in a matter that included, among other things, having a research analyst participate in a road show, and a research analyst giving statements that were not fair and balanced.

There are a number of cases that are now under investigation by NYSE Enforcement. The cases include: research analysts selectively disclosing material non-public information; improper disclosures in research reports; research analysts trading in securities in violation of the SRO Rule blackout prohibitions; research analysts expressing opinions privately about securities they cover that were inconsistent with their published research reports; improper influence of investment banking on research compensation; lack of supervisory analyst qualifications; initiating coverage of a stock during a quiet period; violations of information barrier provisions; violations of the gatekeeper provisions; and books and records violations.

As noted above, there is also an investigation of approximately 30 firms being jointly conducted by the SROs to determine whether firms are in compliance with the requirement to register foreign research analysts who participate in the preparation of member research.

IV. IMPACT OF RULES: ACADEMIC STUDIES AND MEDIA REPORTS

Academic studies and media reports provide both empirical and anecdotal evidence regarding the impact of the SRO Rules,⁴² and most have concluded that the rules have helped to address the conflict-of-interest issues that previously compromised the objectivity and reliability of research. Indeed, as the author of one study states:

[T]he new regulations were successful in their objectives of curbing the excessive optimism driven by the conflicts of interest . . . The distribution of recommendations is now very balanced between buy and sell recommendations . . . and the link between the presence of underwriting business and excess optimism in recommendations was removed.⁴³

⁴⁰ See Exchange HPD 04-136 (NYSE Aug. 11, 2004).

⁴¹ The firm was in violation of NYSE Rule 472(b)(4), which prohibits member firms from providing a subject company with draft research reports containing the research summary, rating or price target information.

⁴² We note that some studies and news articles refer only to the impact of the Global Settlement. Since the key provisions of the Global Settlement closely track those of the SRO Rules, we believe those studies and news articles that address the impact of the settlement terms are a fair proxy for the impact of the SRO Rules.

⁴³ Leonardo Madureira, *Conflicts of Interest, Regulations, and Stock Recommendations*, at 4 (Nov. 2004) (Working paper, Wharton School, University of Pennsylvania) (the “Madureira Study”). See also, e.g., Ohad Kadan, Tzachi Zach & Rong Wang, *Are Analysts Still Biased? The Effect of the Global Settlement and Regulation FD*, Abstract (Mar. 2005) (Working paper, John M. Olin School of Business, Washington

While many other studies and media stories similarly support the effectiveness of the SRO Rules, some contend that the impact has been minimal and that certain conflicts persist. Briefly summarized below are findings and conclusions from a survey of pertinent studies and news articles.

Research Is More Balanced

(a) Changes in ratings distributions

Several academic studies have found that the percentage of buy recommendations decreased and the percentage of sell and hold recommendations increased following adoption of the SRO Rules and Global Settlement. These ratings distribution trends suggest that research analysts are issuing more balanced stock recommendations.

For example, one study found that the percentage of buy recommendations peaked at 74% of all recommendations at the end of the second quarter of 2000 and decreased to 42% of all recommendations at the end of June 2003.⁴⁴ During the same period, sell recommendations increased from 2% to 17% of all recommendations, while hold recommendations increased from 24% to 41%.⁴⁵

The Barber Study concludes that “taking a closer look at the trends in 2002 makes clear that [the SRO Rules]⁴⁶ likely did play a role in analysts’ shift away from buy recommendations.”⁴⁷ Indeed, the study notes that the most pronounced changes in ratings distributions occurred during the weeks leading up to the September 9, 2002 deadline for implementing the ratings distribution disclosure requirement under the SRO Rules.⁴⁸ The single biggest change occurred on Sunday, September 8, 2002 when buy recommendations decreased from 57% to 53% and sell recommendations increased from 8% to 11%.⁴⁹ Adjusting for certain factors, the authors calculate that there was a greater decrease in the percentage of buys and a greater increase in the percentage of sells and holds following implementation of the SRO Rules than otherwise would have been expected.⁵⁰

University) (the “Kadan Study”) (“the Global Settlement was effective in reducing conflicts of interests [sic] between research and investment banking departments in financial services firms”).

⁴⁴ Brad Barber, Reuven Lehavy, Maureen McNichols & Brett Trueman, *Buys, Holds, And Sells: The Distribution Of Investment Banks’ Stock Ratings And The Implications For The Profitability Of Analysts’ Recommendations*, at 3, 12 (Sept. 2005) (Working paper, Graduate School of Management, University of California, Davis, Ross School of Business, University of Michigan, Graduate School of Business, Stanford University and Anderson Graduate School of Management, University of California, Los Angeles) (the “Barber Study”).

⁴⁵ *Id.*

⁴⁶ While the authors refer solely to NASD Rule 2711, they state that all conclusions apply to NYSE Rule 472 as well. *Id.* at 1, n.1.

⁴⁷ *Id.* at 13.

⁴⁸ *Id.*

⁴⁹ *Id.* at 13-14.

⁵⁰ *Id.* at 15.

The Madureira Study found similar results. That study looked at analyst recommendations for the period July 1995 through December 2003 and found that prior to the SRO Rules and Global Settlement, the bulk of consensus recommendations were concentrated in the strong buy and buy categories (accounting for 60% or more of the stocks in the sample) and sell recommendations were “virtually absent.”⁵¹ However, from July 2002 through December 2003, “a completely different pattern emerges.”⁵² For example, in September 2002, the fraction of stocks in the pessimistic category (sell and strong sell) jumped from 3% to approximately 20%.⁵³ The author found similar patterns with respect to initiation of coverage and ratings upgrades and downgrades, finding that brokerage houses leaned less toward optimistic ratings after the new regulations took effect.⁵⁴

Both the Madureira and Kadan studies found the most decided changes in ratings distributions at firms that maintained or pursued investment banking transactions with covered companies. The Madureira Study found that, prior to the SRO Rules and Global Settlement, the presence of an underwriting business with the subject company implied a 50% increase in the odds that a new recommendation would be optimistic.⁵⁵ However, the study found that the effect has “largely disappeared” after the new regulations took effect.⁵⁶

The Kadan Study similarly found that regulatory measures enacted to separate research from investment banking have resulted in less optimistic research by analysts whose firms had or sought investment banking business with companies the analyst covered (an “affiliated” analyst). The study found that prior to the Global Settlement, affiliated analysts generated more optimistic recommendations and long-term growth forecasts than their unaffiliated counterparts; however, those differences have now been eliminated.⁵⁷ Consistent with the Barber and Madureira studies, the Kadan Study found a decrease in the percentage of affiliated analysts’ buy recommendations and an increase in their hold and sell recommendations following the Global Settlement.⁵⁸ The authors found a similar but less dramatic shift in ratings distribution with respect to unaffiliated analyst recommendations.⁵⁹

In a subsequent paper combining the Madureira and Kadan studies, the authors explained that analysts changed their behavior in an asymmetric way after adoption of the SRO Rules.⁶⁰

⁵¹ Madureira Study at 17-18.

⁵² *Id.* at 18.

⁵³ *Id.*

⁵⁴ *Id.* at 21.

⁵⁵ *Id.* at 4.

⁵⁶ *Id.*

⁵⁷ Kadan Study at 4, 26.

⁵⁸ *Id.* at 21-22, Table 6.

⁵⁹ *Id.* at 22.

⁶⁰ Ohad Kadan, Leonardo Madureira, Rong Wang & Tzachi Zach, *Conflicts of Interest and Stock Recommendations - The Effects of the Global Settlement and Recent Regulations*, at 25 (July 2005) (Working paper, John M. Olin School of Business, Washington University and Weatherhead School of Management, Case Western Reserve University).

Analysts now behave similarly when deciding whether to post an optimistic recommendation, and the likelihood of receiving an optimistic recommendation no longer depends on whether the analyst's firm participated in an equity offering for the subject company.⁶¹ However, affiliated analysts are still reluctant to issue pessimistic recommendations for companies that have had a recent equity offering.⁶²

One recent academic study found lesser changes in ratings distributions since the Global Settlement.⁶³ The author analyzed data for each of the ten Global Settlement firms and found that prior to the settlement, between 28.4% (in 2002) to 39.8% (in 2000) of recommendations across the ten firms carried a firm's highest rating. After the settlement, top recommendations comprised between 31.8% (in 2003) and 39% (in 2004) of all recommendations.⁶⁴ The percentage of the most negative recommendations decrease from a pre-settlement range of 24.1% (in 2000) to 32.4% (in 2002) to a post-settlement range of 18.8% (in 2003) and 12.8% (in 2004).⁶⁵ The author notes that the numbers may be explained by factors other than bias, such as analysts' accurate and unbiased expectation of investment value in the post-settlement period or the fact that analysts may intentionally have skewed their coverage post-settlement to stocks that they expect will outperform the market.⁶⁶

A number of news articles buttress the conclusion that sell-side analysts are less biased after implementation of the SRO Rules and/or the Global Settlement and now are more prone to issue downgrades and sell recommendations. According to a recent article, "sell-side analysts do appear to be more discerning," noting that sell ratings, which accounted for less than 2% of the ratings published on Wall Street in 2002, were up to between 10% and 15% of the ratings at all major brokerages.⁶⁷ Another article reported in August 2003 that sell recommendations represented 15-25% of overall opinions, attributing the trend at least in part to adoption of the SRO Rules.⁶⁸ According to *The Wall Street Journal*, at one point in 2000, 95% of the stocks in the S&P 500 had no sells at all and no stock had more than one sell rating; today, only 38% are without sell recommendations, 62% have at least one sell and 9% have five sells or more.⁶⁹

⁶¹ *Id.*

⁶² *Id.* at 25-26.

⁶³ Leslie Boni, *Analyzing the Analysts After the Global Settlement*, at 5 (Aug. 25, 2005) (Working paper, University of New Mexico) (the "Boni Study").

⁶⁴ *Id.* at 13.

⁶⁵ *Id.*

⁶⁶ *Id.* at 14.

⁶⁷ Nat Worden, *Mixed Returns on Spitzer Research Settlement*, The Street.com, Apr. 22, 2005, <http://www.thestreet.com/markets/natworden/10218183.html>. See also Dan Ackman, *Wall Street Tries To Say 'Sell'*, Forbes.com, June 20, 2003, http://www.forbes.com/2003/06/20/cx_da_0620topnews_print.html (in June 2003, 43% of recommendations were buy, 46.6% were hold and 10.5% were sell, compared with June 2000, when 74.6% of all recommendations were buy and only 0.7% were sell); *Facts Without Fiction*, Crystal Research Assoc., LLC, Issue 3 (Winter 2005); *Analysts Say 'Sell' A Lot More Often*, Reuters News Service, May 18, 2003, <http://www.chron.com/dispatch/story.mpl/business/mym/1914061.html>.

⁶⁸ Andrew Leckey, *Dumping Stock Shouldn't Be Such A Hard Sell*, Chicago Tribune, Aug. 12, 2003, at C4.

⁶⁹ E.S. Browning, *Analysts Keep Misfiring With 'Sell' Ratings*, Wall St. J., Apr. 11, 2005, at C1.

Some news stories also report that bias still exists, particularly at larger firms with investment banking businesses.⁷⁰ According to one report, the top ten Wall Street firms give a higher percentage of buy ratings – 46% versus 40% – to those companies with which they do investment banking business.⁷¹ Another article reports that many firms still maintain only 0-6% sell recommendations.⁷² Finally, one news article reports that small firms may be slightly more likely to issue buy recommendations than the Global Settlement firms.⁷³

(b) *Correlation between recommendations and earnings forecasts*

A recent academic study attempted to measure research bias after the SRO Rules by examining the relationship between earnings forecasts and recommendation profitability across three groups of sell-side analysts: “top-tier” analysts at the top investment banks, other investment bank analysts and non-investment bank analysts.⁷⁴ Absent bias, the authors believe that there should be a strong correlation between accuracy in predicting earnings and profiting from following analyst recommendations since most recommendations are derived from earnings analysis. The authors further posit that bias is more likely to appear in recommendations than earnings forecasts because analysts’ reputations are tied more closely to accurately predicting earnings.

During the 1993 to 2000 period, the study found a “positive and significant association” between forecast accuracy and recommendation profitability for non-investment bank analysts, but no such relation for top-tier analysts and other investment bank analysts.⁷⁵ The authors suggest that this finding demonstrates that before the SRO Rules, the presence of conflicts at investment banks resulted in overly optimistic recommendations disconnected from earnings forecasts.⁷⁶ However, in the period following the Global Settlement and implementation of the SRO Rules, the study found such positive correlation between earnings forecast accuracy and recommendation profitability for analysts employed by top-tier investment banks, suggesting that “the increased awareness of the conflicts of interest and the regulatory changes might have had their desired effect.”⁷⁷

⁷⁰ See, e.g., Amey Stone, *Yes, Wall Street Research Is Better*, BusinessWeek Online, June 28, 2004, http://businessweek.com/bwdaily/dnflash/jun2004/nf20040628_1253_db014.htm (“some might conclude that bias still exists”).

⁷¹ *Id.*

⁷² Joseph McCafferty, *Reform of Sell-side Research is Creating A Variety of New Headaches for Corporations*, CFO Magazine, May 2003. See also Leckey, *supra* note 68.

⁷³ Susanne Craig, *Research Rules Trickle Down To Small Firms*, Wall St. J. Online, Jan. 18, 2004, <http://online.wsj.com/article/o,,SB107446466140004574,00.html>.

⁷⁴ Yonca Ertimur, Jayanthi Sunder & Shyam V. Sunder, *Measure for Measure: An Examination of the Association between Forecast Accuracy and Recommendation Profitability of Sell-Side Analyst* (Mar. 2005) (Working paper, Graduate School of Business, Stanford University and Kellogg School of Management, Northwestern University) (the “Ertimur Study”).

⁷⁵ *Id.* at 4.

⁷⁶ *Id.* at 2.

⁷⁷ *Id.* at 19.

Research Is More Reliable, Accurate And Informative For Investors

Recent studies and a number of news articles suggest that the quality of research and value to investors has improved since adoption of the SRO Rules. For example, one article reports that the “most important change for the better is in the quality of analysis . . . written commentary in stock reports is more independent, more thought-provoking, and better represents the upside and downside potential for a stock than the bubble era’s much-hyped reports.”⁷⁸ And in numerous interviews, portfolio managers attest to the improvement.⁷⁹ Another article reports that “the investment community is now benefiting from more diverse research strategies, with access to reports that are less restricted and more user-friendly.”⁸⁰ As discussed in more detail below, research has also become more trusted by the market and more reliable and meaningful for investors.

(a) Ratings reflect their plain meanings

The SRO Rules require that ratings be consistent with their plain meanings, and several studies have concluded that ratings indeed are now truer and therefore more predictive for investors. For example, the Kadan Study found that following the Global Settlement, the price reaction in the market to buy recommendations has been “significantly more positive” and the price reaction to hold recommendations has been “significantly less negative.”⁸¹ In other words, the market now accepts ratings at face value and stocks trade consistent with the plain meanings of the recommendations. According to the Kadan Study, these results suggest that buy and hold recommendations are now “more informative to investors.”⁸² As for sell recommendations, the Kadan Study found more mixed results.⁸³ The Madureira Study also found that firms now generally seem to “mean what they say” when issuing hold and sell recommendations,⁸⁴ concluding that “brokerage houses no longer are disguising pessimistic recommendations as neutral ratings.”⁸⁵ In contrast, before the SRO Rules and Global Settlement, a hold rating often was tantamount to a sell recommendation,⁸⁶ which would generate far greater negative price reaction in the market than the author has found since implementation of the regulations.

⁷⁸ Stone, *supra* note 70 (in the “bad old days,” research on the same company was “often barely distinguishable” among research firms).

⁷⁹ *Id.* See also McCafferty, *supra* note 72 (most experts expect analysts to “dig deeper into the companies they cover”).

⁸⁰ *Facts Without Fiction*, *supra* note 67, at 1 (noting that research is now “a competitive marketplace of versatile and diverse research providers”). See also *SIA Research Management Conference: Reflections on Two Years Since the Global Settlement*, SIA Research Reports, Vol. VI, No. 9 (Sept. 30, 2005) (“panelists agreed that there is a far greater variety of research products and services available today”).

⁸¹ Kadan Study at 20.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ Madureira Study at 3, 25-26.

⁸⁵ *Id.* at 25, 26. The study did, however, find some negative market reactions to hold recommendations issued by non-settling firms.

⁸⁶ Madureira Study at 2.

However, one recent academic study has found that investors are less responsive to analyst recommendations. The Boni Study found that market participants on average respond less to recommendation changes made by the ten settlement firms after the Global Settlement (*i.e.*, stock prices increase less on upgrades and decrease less on downgrades than they did prior to the Global Settlement).⁸⁷ The author notes that it is possible that retail investors react to analyst recommendations as they did before the settlement but institutional investors respond less.⁸⁸

(b) *Recommendations may be more accurate and predictive of investment profitability*

Reports suggest that research has become more accurate following implementation of the SRO Rules and the Global Settlement, which served “as a wake-up call for many sell-side research professionals As a result, broker/dealers and investment banks are now paying much more attention to the accuracy of their research recommendations.”⁸⁹

And there is evidence that investors who follow recommendations may be seeing improved returns. For example, the Barber Study concluded that the disclosure requirements in the SRO Rules provide investors with helpful information to assess the value of a research analyst’s recommendation and to predict profitability by investing consistent with those recommendations. The authors found that prior to the implementation of the SRO Rules, upgrades from brokers with the highest percentage of pessimistic ratings outperformed by an average of 50 basis points those brokers that tended to have a more optimistic ratings distribution.⁹⁰ The obverse also held true: downgrades to hold or sell from the more optimistic brokers significantly outperformed investments in stocks downgraded by brokers with more pessimistic ratings distributions.⁹¹ The authors note that these differences have effectively evaporated after implementation of the SRO Rules, leading to their conclusion that the ratings distribution disclosure requirement has made research more transparent for investors.⁹²

According to Starmine, a firm that rates analyst performance, following analysts’ advice would have had a slightly negative impact on portfolios on average in 2002; however, in 2003, it would have added 2.2 percentage points to returns.⁹³ In 2004, analysts outperformed benchmarks by

⁸⁷ Boni Study at 19.

⁸⁸ *Id.* However, this seems inconsistent with the author’s observation that according to polls, most institutional investors said that they largely ignored analysts’ recommendation ratings prior to the Global Settlement. *Id.* at 3.

⁸⁹ Integrity Research Assoc. & Meghan Leerskov, *Gauging The Independent Edge*, Buyside, June 2004, at 61, 66. *See also* Stone, *supra* note 70 (quoting a senior analyst at First Call as saying that research over the prior two years “has become more objective, more original, and more accurate”).

⁹⁰ Barber Study at 6, 31.

⁹¹ *Id.*

⁹² *Id.* at 36.

⁹³ Stone, *supra* note 70. *See also* Daniel Gross, *The Best Stock Tips in Town - Buy When These Guys Say Buy, Not When Those Guys Say Buy*, Aug. 4, 2004, <http://slate.msn.com/id/2104760> (according to a Smith Barney study, investors who heeded consensus advice from mid-2001 through mid-2003 would have lost money, including a loss of more than 35% in the fourth quarter of 2001; however, there were two straight

1.3 percentage points.⁹⁴ In addition, by 2005, five of the top ten best-performing research shops were sell-side brokerages, as opposed to two years ago, when independent analysts occupied nine of the top ten spots.⁹⁵

On the other hand, the Boni Study found very little change in the performance of analyst recommendations. The Boni Study found that stocks that received the strongest recommendations of settling firm analysts outperformed the S&P 500 index both before and after the Global Settlement.⁹⁶ The study found the same to be true for stocks that received the analysts' worst ratings and in fact, more often than not, such stocks outperformed those stocks that received analysts' strongest recommendations both before and after the Global Settlement.⁹⁷ In discussing these findings, the author noted that both before and after the Global Settlement, recommended stocks that outperformed the S&P 500 index did so at least in part because they are riskier investments on average.⁹⁸

Some news reports also have suggested that the accuracy of research has not improved appreciably as a result of the SRO Rules. An analysis performed for *The Wall Street Journal* indicates that analysts are doing no better a job of picking stocks than they were before the research scandals.⁹⁹ The article reported that since 2000, "even though Wall Street supposedly has become more discriminating," stocks with large proportions of sell ratings are performing better than those with buy and hold ratings.¹⁰⁰ In 2003-2004, stocks with the most sell ratings rose 36% on average, while those with the most buys rose just over 25%.¹⁰¹

Research Ratings Have Been Simplified

The SRO Rules also have led to widespread adoption of simplified ratings systems. As the Madureira Study explained, the new ratings systems are simplified in terms of the number of ratings categories and the meaning among analysts is "very uniform."¹⁰² Eight of the ten Global Settlement firms adopted new ratings system in 2002, and many of the next largest brokerage

quarters of positive performance in the second half of 2003); Melissa Lee & John Metaxas, *Change Comes Slowly To Wall St. Research*, Apr. 26, 2004, <http://msnbc.msn.com/id/4816690/print/1/displaymode/1098>.

⁹⁴ Matt Krantz, *Analysts Deliver Better Advice*, Feb. 9, 2005, <http://www.investars.com/articles20050209.asp>; Jane J. Kim, *Stock Research Gets More Reliable*, Wall St. J., June 7, 2005, at D1.

⁹⁵ Worden, *supra* note 67. See also Kim, *supra* note 94 (some of the brokerage firms that were part of the Global Settlement have climbed higher in rankings of the best-performing research shops).

⁹⁶ Boni Study at 5.

⁹⁷ *Id.*

⁹⁸ *Id.* at 5-6.

⁹⁹ Browning, *supra* note 69.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Madureira Study at 13. The author noted that the changes in ratings systems came about in response to the SRO Rules, which "express[ed] the regulators' concern about ratings systems that were loosely defined and perhaps not properly understood by the research's clients." *Id.* at 11.

houses began to adopt new systems around the same time.¹⁰³ Only one of the new ratings systems was adopted before the SRO Rules became effective in July 2002, and many came on line contemporaneous with the September 9, 2002 implementation date of the SRO Rules ratings distribution requirements.¹⁰⁴ Most large brokerage houses now use a three-tier ratings system, and every new ratings system adopted after 2001 is a three-tier system.¹⁰⁵

Some news articles indicate that research can still be confusing for investors, since not all brokerages have adopted new ratings systems, and there is no mandated or accepted uniform ratings system for those that have them.¹⁰⁶

Conflicts Of Interest Have Been Reduced But Not Eliminated

Numerous articles provide anecdotal evidence that the conflicts of interest arising from the close relationship of research and investment banking have been mitigated following implementation of the SRO Rules and Global Settlement. For example, one investment bank had to drop out of a large IPO in May 2005 after its top media research analyst told the firm's senior bankers that they were overpricing the shares.¹⁰⁷ In another example, analysts at two firms that launched a recent hot IPO began coverage on the stock with an "underperform" rating.¹⁰⁸

However, a December 2004 *Newsweek* article reports that despite the regulatory changes and Global Settlement, the "big financial firms are still rife with conflicts that put their own interests, and those of big banking clients, ahead of everyone else's."¹⁰⁹ The article cites as evidence of such conflicts the fact that analysts can still meet with executives around the time they are considering which investment bankers to hire and investment banking fees continue to flow into a pool of money used to pay analysts.¹¹⁰ Another article reports that "at some firms, banking and research were still a little too cozy" and companies looking for underwriters "still want to be sure they'll get positive research coverage once their stock is issued."¹¹¹ According to the article,

¹⁰³ *Id.* at 11.

¹⁰⁴ *Id.* at 13; *see also* Barber Study at 14.

¹⁰⁵ Madureira at 13. The result of the change in ratings system was that many outstanding recommendations were downgraded. *Id.* at 14. More than 90% of the stocks newly rated pessimistic were rated at least neutral under the old system, and more than 40% of the stocks newly rated neutral were rated at least buy/strong buy under the old system. *Id.*

¹⁰⁶ Susanne Craig & Ann Davis, *Analyze This: Research Is Fuzzier Than Ever*, Wall St. J., Apr. 26, 2004 at C1 (ratings are not comparable across firms because the SRO rules do not require a uniform methodology).

¹⁰⁷ Andrew Ross Sorkin & Jeff Leeds, *Has Wall Street Changed Its Tune?*, June 19, 2005, <http://boycott-riiaa.com/article/17252> (stating that "[t]hroughout Wall Street, research analysts at major investment banks are increasingly showing a new sense of independence"). *See also* Joseph Nocera, *Wall Street on the Run*, June 14, 2004, http://www.pbs.org/wsw/news/fortunearticle_20040614_02.html (reporting that there have been "plenty of stories about analysts, freed from pressure from bankers, who vetoed important underwriting deals").

¹⁰⁸ Matt Krantz, *IPO underwriters' ratings get tougher, Baidu.com hit*, USA Today, Sept. 14, 2005.

¹⁰⁹ Charles Gasparino, *The Street's Dark Side*, Newsweek (U.S. Edition), Dec. 20, 2004, at 40.

¹¹⁰ *Id.*

¹¹¹ Nocera, *supra* note 107.

research continues to be used to attract banking business.¹¹² Another article suggests that “change has come more slowly to smaller securities firms.”¹¹³ The article tells the story of one analyst who, after adoption of the SRO Rules, received a voice mail from a banker scolding him for a negative report and threatening that the analyst’s compensation is still determined by investment banking revenue.¹¹⁴

A Harvard Business School professor who has studied research analysts said in an interview that even where research is separated from investment banking, conflicts of interest persist.¹¹⁵ These conflicts arise because (1) sell-side analysts have incentives to hype stocks to generate trading business through large institutional investors who may be clients of the brokerage firm, and (2) once a sell-side analyst has prompted an institutional client to take a large position in a stock recommended by the analyst, the analyst faces a disincentive to downgrade the stock and thereby impact the value of the client’s position.¹¹⁶

In addition, while the SRO Rules may have lessened the internal pressure on analysts, there have been a number of reports indicating that analysts are coming under external pressure – retaliation by issuers against analysts who have downgraded their stock.¹¹⁷ Some say that the regulatory reforms splitting investment banking from stock research could shift the source of pressures from investment banking to the issuers.¹¹⁸

Research Coverage Has Diminished

Several press accounts report that the number of companies covered by research analysts has decreased since the implementation of the Global Settlement and SRO Rules. A recent report says that since 2002, 691 companies have lost analyst coverage altogether and 99% of the

¹¹² *Id.* See also *Timing of Stock Issuance Raises Eyebrows After Upgrade*, Wall St. J., Sept. 14, 2005, at C1 (within two days after research analyst upgraded stock, employing firm won the right to lead a stock issue for the company).

¹¹³ Craig, *supra* note 73.

¹¹⁴ *Id.*

¹¹⁵ Ann Cullen, *The Bias of Wall Street Analysts*, Oct. 18, 2004, http://hbswk.hbs.edu/tools/print_item.jhtml?id=4430&t=entrepreneurship.

¹¹⁶ *Id.*

¹¹⁷ Gretchen Morgenson, *You’ll Never Do Research in This Town Again*, N.Y. Times, July 31, 2005, at BU 1 (fear of retaliation from the companies they follow may explain analysts’ unreasoned optimism); Adrienne Baker, *Leader: Spitzer’s Next Challenge?* Apr. 2005, <http://ironthenet.com/feature.asp?current=1&articleID=4048> (in a survey of 732 analysts, 40% said they felt shut out by a firm after they downgraded its equity and another 6% said that companies had threatened to suspend banking relationships following a downgrade); Melissa Lee & John Metexas, *When Companies Behave Badly To Analysts*, Apr. 29, 2004, <http://msnbc.msn.com/id/4816980/print/1/displaymode/1098/>; Richard J. Wayman, *Are Analysts ‘Too’ Independent? Apparently The French Think So*, Jan. 30, 2004, <http://www.researchstock.com/cgi-bin/rview.cgi?c=bulls&rsrc=RC-20040130-F>; Deborah Solomon & Robert Frank, *You Don’t Like Our Stock? You Are Off The List*, Wall St. J., June 19, 2003, at C1; *Corporate Retaliation on Analysts*, Apr. 8, 2003, <http://www.ironthenet.com/static/disclosure/USCanada/CorporateRetaliation0403.htm>.

¹¹⁸ Solomon & Frank, *supra* note 117.

companies that have lost coverage are smaller companies with a stock market value of less than \$1 billion.¹¹⁹ According to Reuters Research, as of January 2004, 666 companies in its database of 4,075 had been “orphaned” by sell-side analysts, while in 2002, only 85 companies were left without analyst coverage.¹²⁰ Of the companies that have not been orphaned, 380 are down to a pair of analysts, while 473 companies have just one.¹²¹ Similarly, a recent academic study has found that the number of stocks covered by the ten Global Settlement firms has dropped an average of 14% relative to 2000 and 20% relative to 2001.¹²² However, three of the ten firms show little change or even an increase in the number of companies they covered pre- and post-settlement.¹²³

On the other hand, at least one article indicates that there has been no loss in coverage. In June 2004, First Call, which monitors and distributes analysts’ reports, said that as much research coverage is being generated and that 4,158 companies were being covered, down from 4,257 in June 2002.¹²⁴

To the extent that coverage has diminished, some of the cutback has been attributed to the new regulatory environment, while others say that it is not clear that the new regulations are wholly to blame,¹²⁵ and some blame “long-term economic forces.”¹²⁶

¹¹⁹ Susanne Craig, *Firm To Research Stock ‘Orphans’*, Wall St. J., June 7, 2005, at C3. *See also* SIA Research Reports, Vol. VI, No. 9, at 12 (“Panelists also agreed that there appears to be a decline in the coverage of smaller stocks (those with market capitalization lower than \$1 billion), which has a negative impact on capital formation.”); Robert Scott Martin, *Issuer-Paid Research Comes of Age*, Buyside (2005), <http://www.buyside.com/archives/2005/0501/0501fidea.asp> (64% of all publicly traded companies do not have sell-side coverage and if over-the-counter stocks are included, the number jumps to 80%); Ritu Kalra, *Paid-For Research Scores With Investors*, Reuters, July 17, 2004, http://www.boston.com/business/articles/2004/07/17/paid_for_research_scores_with_investors/ (for companies whose market capitalization is less than \$500 million, overall coverage is down by more than 35% since 2001 and nearly 60% of all publicly traded companies in the U.S. get no coverage at all); Lee & Metaxas, *supra* note 93 (Morgan Stanley cut stocks covered in North America by 26% and Merrill by 30%); Landon Thomas Jr., *Changed Smith Barney Is Thin on Analysts*, N.Y. Times, June 13, 2003, at C1 (Smith Barney discontinued coverage – at least temporarily – of close to 250 companies); McCafferty, *supra* note 72 (in 1998, 6,100 companies drew coverage from at least one analyst, but by May 2003, that number was down 30%, to 4,300).

¹²⁰ Marie Leone, *The Flight of The Sell-Side Analyst*, July 8, 2004, <http://www.cfo.com/printable/article.cfm/3015019?f=options>.

¹²¹ *Id.*

¹²² Boni Study at 4.

¹²³ *Id.* at 12.

¹²⁴ Stone, *supra* note 70 (noting that this decline may reflect the absence of IPOs and merger activity rather than research changes).

¹²⁵ Rachel McTague, *Goldschmid Concerned About Reduction In Broker-Dealers’ Budgets For Research*, BNA, Inc., Sept. 21, 2004.

¹²⁶ Martin, *supra* note 119.

Research Industry Has Changed

There have been many reports that the “old research model is dead,”¹²⁷ although little consensus has emerged as to the new models. Summarized below are some additional reported changes in the research industry, not discussed elsewhere in this section, since the implementation of the SRO Rules and Global Settlement.

- Institutional investors are diverting equity commission dollars away from Wall Street’s traditional research to securing access to analysts and company management.¹²⁸
- There has been a decrease in sell-side research staff and budgets in light of the separation of research from investment banking revenue.¹²⁹
- Sell-side analysts are migrating to the buy-side/money management firms.¹³⁰

¹²⁷ Nocera, *supra* note 107. See also Kyle L. Brandon, *Update on Research Analysts Related Issues*, SIA Research Reports, Vol. VI, No. 5, at 8 (May 27, 2005) (to date, “sell-side firms have not come up with an answer to the question ‘what is the new business model after the global settlement?’”).

¹²⁸ James Langton, *Study Shows Institutions Moving Away From Wall St. Research*, July 13, 2005, <http://www.investmentexecutive.com/client/en/News/ImprimerDetail.asp?Id=29645&IdSe>.

¹²⁹ SIA Research Reports, Vol. VI, No. 9, at 11 (one panelist estimated that research lost half of its funding with the loss of investment banking revenues at the same time that commission revenue fell by 30%); Mara Der Hovanesian & Amy Borrus, *Can The Street Make Research Pay? In The Eliot Spitzer Era, It’s Looking More and More Like An Expensive Luxury*, Jan. 31, 2005, <http://www.capco.com/print.aspx?page=%2fpress.aspx%3fid%3d536> (research budgets at the seven biggest U.S. securities firms have fallen by more than 40% since 2000); McTague, *supra* note 125 (research budgets are down by as much as one-third at some broker-dealer firms); Leone, *supra* note 120 (the number of sell-side analysts has decreased by 15-20% over the last few years); Adam Piore, *Can Investors Get An Honest Stock Tip On (Or Off) Wall Street?*, Newsweek Int’l, Mar. 2004, <http://www.msnbc.msn.com/id/4468645> (HSBC announced that it would stop picking stocks altogether, declaring the old research model “broken”); Ann Davis, *Increasingly, Stock Research Serves The Pros, Not ‘Little Guy’*, Wall St. J., Mar. 5, 2004, at A1; Daniel Dunaief, *Analysts Abandon Wall St.*, N.Y. Daily News, Feb. 24, 2003, <http://www.nydailynews.com/business/v-pfriendly/story/61941p-57842c.html> (analysts are leaving Wall Street and research has become more bureaucratic in light of new regulations).

¹³⁰ Greg Crawford, *Money Managers Beefing Up Their Research Staffs; Search For New Ideas Spurs Firms Into Action*, Investment News, June 20, 2005, at 15 (money managers are beefing up their research staffs and between early 2003 and early 2005, the average research staff at U.S. buy-side institutions increased from 9.3 to 10.5 people); Bill Slocum, *Is There A Future For Wall Street Research?*, June 27, 2003, <http://www.researchstock.com/cgi-bin/rview.cgi?c=outside&rsrc=RA-20030627-F> (in-house equity analysts are being asked to cover more industries and companies than ever before); *Sell Side Gets A Boost*, June 23, 2003, <http://www.ironthenet.com/newsarticle.asp?current=1&articleID=2761> (reporting on the increased pressure on buy-side analysts to cover more industries); Paula Lace, *Sell-Side Analysts Make A Break For The Buy Side*, TheStreet.com, Mar. 5, 2003, <http://www.thestreet.com/markets/paulalace/10072239.html> (the shift to the buy-side could result in making the research industry “even more clubby”).

- Many companies are outsourcing research staff to foreign countries, such as India.¹³¹
- Research is not going to the small investor, whom the regulations were designed to protect, but to institutional investors.¹³²
- Issuer-paid research is on the rise as a result of the loss of coverage.¹³³

V. REVIEW OF RULE PROVISIONS

A. Analytical Framework for Review

The SRO staffs have conducted a section-by-section review of the SRO Rules to determine whether any additions, deletions or amendments are warranted. In evaluating each provision, the SRO staffs have been guided by several analytical touchstones. First, the SRO staffs looked to the principles that underpinned the original rule development to see if a provision is accomplishing its intended purpose. Second, the SRO staffs reviewed findings from examinations, sweeps and enforcement actions. Third, the SRO staffs considered interpretive requests and member questions. Fourth, the SRO staffs compared the rules to the provisions of the Global Settlement. Fifth, the SRO staffs considered potential gaps or overbreadth in the existing rules. Finally, the SRO staffs considered suggestions from industry groups and members.

B. Section-by-Section Review

Set out below is a discussion of those provisions for which the SRO staffs recommend amendments or further interpretation to the rules. The SRO staffs believe that the other provisions of the SRO Rules are operating effectively and efficiently in achieving their purpose,

¹³¹ Der Hovanesian & Borrus, *supra* note 129; Davis, *supra* note 129; Khozem Merchant & David Wells, *Banks Move Analysts' Work To India*, Financial Times (London), Aug. 20, 2003, at 1.

¹³² Davis, *supra* note 129 (“the most pioneering, market-moving research is going exclusively to big mutual funds and the private investment pools known as hedge funds”).

¹³³ SIA Research Reports, Vol. VI, No. 9, at 12 (summarizing panel discussion on the issue of “made-to-order” research tailored to meet client requests); Martin, *supra* note 119 (paid-for researchers “have taken strict measures to keep their work as independent as humanly possible”); Kalra, *supra* note 119 (portfolio managers are overcoming their skepticism of issuer-paid research, citing impressive performance and access to information on companies large Wall Street investment banks do not cover); Melissa Lee & John Metaxas, *Beware of Wall St. 'Research For Hire'*, Apr. 28, 2004, <http://www.msnbc.msn.com/id/4816907/print/1/displaymode/1098/> (current regulations are not strong enough to protect investors vis-à-vis research for hire and if an analyst is not associated with a broker-dealer, perhaps “caveat emptor” should apply); Ann Davis, *Wall Street, Companies It Covers, Agree on Honesty Policy*, Wall St. J., Mar. 11, 2004, at C1 (discussing best practices guidelines that were a joint effort between the Association for Investment Management and Research and the National Investor Relations Institute); Lynn Cowan, *Research-For-Hire Shops Growing, Seeking Legitimacy*, Wall St. J. Online, July 7, 2003, http://online.wsj.com/article_print/0,,BT_CO_20030707_001632,00.html; Thomas S. Mulligan, *Ignored by Wall St., Firms Turn To Research-For-Hire Outfits; As The Fee-Based Industry Tries To Fill The Gap Left By The Withdrawal of Analyst Coverage, Some Experts Have Reservations*, Los Angeles Times, June 3, 2003; McCafferty, *supra* note 72.

and therefore no changes are recommend to those provisions at this time. In making the recommendations, the SRO staffs are mindful that consideration must be given to the mandates of Sarbanes-Oxley and that, in certain instances, implementing the recommendation may require an exemption from the SEC. The SRO staffs did not attempt to address every interpretive issue that may be outstanding and will continue to entertain interpretive requests on a case-by-case basis and to publish, as warranted, additional joint memoranda setting forth key interpretations.

1. Definitions

Current Rules

The SRO Rules currently include the following defined terms:

“Public appearance” means 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.

“Research report” means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

“Research analyst” means the associated person who is primarily responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of “research analyst.”

Recommended Changes

The SRO staffs recommend several changes to the definitions in NASD Rule 2711 and NYSE Rule 472 to make certain interpretations express in the rule language and to circumscribe the scope of communications subject to the SRO Rules.

“Public Appearance”

The SRO staffs recommend amending the definition of “public appearance” to codify an interpretation consistent with SEC Regulation AC that the term applies only to appearances involving 15 or more separate investors. The SRO staffs further recommend that the definition also codify an exception to that interpretation contained in NASD *Notice to Members* 04-18 and NYSE Information Memo 04-10: that it excludes password-protected Webcasts, conference calls and similar events with 15 or more existing customers, provided that the participants previously received the most current research report or other documentation that includes the disclosures required by the SRO Rules and that the research analyst making the appearance corrects or updates any disclosures that are inaccurate, misleading or no longer applicable.

“Research Report”

The SRO staffs recommend several amendments to the definition of “research report.”

First, the SRO staffs suggest codifying the various exceptions to the definition set forth in the two joint interpretive memoranda.¹³⁴ These exceptions essentially parallel those in SEC Regulation AC and the Global Settlement and are set forth below:

- reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index;
- reports commenting on economic, political or market (including trading) conditions;
- technical or quantitative analysis concerning the demand and supply for a sector, index or industry based solely on trading volume and price;
- reports that recommend increasing or decreasing holdings in particular industries or sectors or types of securities;
- statistical summaries of multiple companies' financial data and broad-based summaries or listings of recommendations or ratings contained in previously-issued research reports, provided that such summaries or listings do not include any narrative discussion or analysis of individual companies; and
- notices of ratings or price target changes that do not contain any narrative discussion or analysis of the subject company, provided that the member simultaneously directs the readers of the notice as to where to obtain the most recent research report on the subject company that includes the disclosures required by the rule, and the notice does not refer to a research report that contains materially misleading disclosure, such as where the disclosures are outdated or no longer applicable.

In addition, the SRO staffs recommend codifying two other exceptions to the definition of “research report” contained in the March 2004 Joint Memorandum and SEC Regulation AC. These exceptions exclude certain communications even if they include information reasonably sufficient upon which to base an investment decision or a recommendation or rating of individual securities or companies:

- any communication delivered to fewer than 15 persons; and
- periodic reports, solicitations or other communications prepared for current or prospective investment company shareholders (or similar beneficial owners of trusts and limited partnerships) or discretionary investment account clients that discuss individual securities, provided that such communications discuss past performance or the basis for previously made discretionary investment decisions.

Second, the SRO staffs recommend explicitly excluding from the definition sales material regarding registered investment companies and direct participation programs (“DPPs”). Since investment companies and DPPs are “equity securities” as defined in Section 3(a)(11) of the Securities Exchange Act of 1934, related sales material that contains an analysis of those

¹³⁴ See NASD *Notices to Members* 02-39 (July 2002) and 04-18 (Mar. 2004) and NYSE Information Memos 02-26 (June 26, 2002) and 04-10 (Mar. 9, 2004).

securities and information sufficient upon which to base an investment decision technically is covered by the definition. Yet sales material regarding investment companies is already subject to a separate regulatory regime, including NASD Rule 2210, NYSE Rule 472 and SEC Rule 482, and all advertisements and sales literature regarding investment companies and DPPs must be filed with the NASD Advertising Regulation Department. Moreover, the SRO staffs do not believe that the conflicts underpinning the SRO Rules are manifest to the same extent with respect to research on investment companies and DPPs.

Third, the SRO staffs recommend codifying a longstanding interpretation that communications that constitute prospectuses under the Securities Act of 1933, including free-writing prospectuses as defined under the SEC's recent Securities Offering Reform rules,¹³⁵ are not considered "research reports," even if they meet the definitional elements. Such prospectuses facilitate differing purposes from research reports and are subject to a separate comprehensive regulatory scheme.

"Research Analyst"

Several industry members have urged the SROs to amend the definition of "research analyst" to exclude any member personnel who are not principally engaged in the preparation or publication of research reports – a limitation contained in the Global Settlement. The SRO Rules, in accordance with the mandates of Sarbanes-Oxley, are constructed such that the author of a communication that meets the definition of a "research report" is a "research analyst," irrespective of his or her title or primary job. This prevents firms from circumventing the rules by redirecting through other channels, such as registered representatives or traders, potentially biased research that is not subject to the SRO objectivity safeguards.

The SRO staffs believe it is important to maintain such communications as research reports subject to the rules and those principally responsible for their preparation as research analysts. However, the SRO staffs recommend consideration of a limited exemption from the registration requirements for non-research personnel that produce research reports. The SRO staffs believe that the registration and qualification requirements were intended for those individuals whose principal job function is to produce research, while the balance of the SRO Rules are intended to foster objective analysis of equity securities and transparency of certain conflicts and to provide beneficial information to investors.

2. Restrictions on Investment Banking Department Relationship with Research Department

Current Rules

The SRO Rules permit investment banking and other non-research employees, other than legal and compliance personnel, to review a research report before publication only to verify the factual accuracy of information in the report or identify a potential conflict of interest. The rules further require that an authorized legal or compliance official act as intermediary for all such permissible communications.

¹³⁵ Securities Offering Reform, Securities Act Release No. 8591 (July 19, 2005), 70 FR 44722 (Aug. 3, 2005).

Recommended Changes

The SRO staffs recommend eliminating the provision that permits pre-publication review of research by investment banking and other non-research personnel, other than by legal and compliance. The SRO staffs believe that review of facts in a report by investment banking personnel is unnecessary in light of the numerous other sources available to verify factual information and only raises concerns about the objectivity of the report. Such review may invite pressure on a research analyst from investment banking personnel that could be difficult to monitor.¹³⁶

The SRO staffs note that such factual review is not permitted under the terms of the Global Settlement. Moreover, legal and compliance can adequately perform a conflict review without sharing draft research reports with investment banking personnel.

3. Restrictions on Solicitation of Investment Banking Business

Current Rules

The SRO Rules prohibit research analysts from participating in efforts to solicit investment banking business, including pitch meetings with prospective clients.

Recommended Changes

This provision, which mirrors language in the Global Settlement, strikes at a core conflict that can compromise research analysts' objectivity when they and their research are utilized to win business rather than provide dispassioned analysis. While the SRO staffs believe this provision is operating effectively, some members have asked for additional guidance regarding references to research analysts and research in pitch books and related meetings. The SRO staffs note that the SEC has provided interpretive guidance to the parallel provisions of the Global Settlement and concluded that it would be inconsistent with the purpose of the solicitation ban to include in a pitch book or related presentation materials any information regarding an analyst employed by a firm or an analyst's views. The SRO staffs generally agree with that guidance and intend to address this area in more detail in a future interpretive memorandum.

4. Restrictions on Sales and Marketing Activities

Current Rules

The SRO Rules prohibit 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 also are prohibited from directing a research analyst to engage in sales or marketing efforts or to engage in any communication with a current or prospective customer related to investment banking transactions.

¹³⁶ See, e.g., Craig, *supra* note 73.

Recommended Changes

This provision, which is substantially the same as a comparable provision in the Global Settlement, seeks to address potential conflicts of interest during the period that firms market securities offerings for issuers. While the SRO staffs believe this provision is operating effectively, some members have asked for additional guidance on whether research analysts can listen to or view an investment banking or company-sponsored road show or other presentation to investors or the analysts' sales force.

The SRO staffs note that the SEC has provided interpretive guidance on the parallel provision of the Global Settlement and concluded that it would not be inconsistent with 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). The SEC has further stated that if the road show or other widely attended presentation to investors or the sales force is conducted at the firm's offices, research personnel may listen-in from the same address as investment banking, investors or the sales force, but may not be in the same room as investment banking, investors or the sales force. The SRO staffs generally agree with that guidance and intend to address this area in more detail in a future interpretive memorandum.

5. Restrictions on Publishing Research Reports and Public Appearances

Current Rules

The SRO Rules set forth, in accordance with the mandates of Sarbanes-Oxley, "quiet periods" during which a member is prohibited from publishing or otherwise distributing a research report and a research analyst is prohibited from making a public appearance. These quiet periods apply in two circumstances: (1) after a public offering of securities and (2) before and after the expiration, waiver or termination of a lock-up agreement entered into by a member with a subject company that restricts the sale of securities by that company or its shareholders.

With respect to the former, the SRO Rules establish different quiet periods depending on whether the offering is an IPO or secondary offering and whether the member acted as manager or co-manager. A member that acted as a manager or co-manager of an IPO may not publish or otherwise distribute research for 40 calendar days following the date of the offering; all other members that participated as an underwriter or dealer in the offering are subject to a 25-day quiet period. A ten-day quiet period applies only to the manager and co-manager of a secondary offering.

The rules contain an exception that permits publication and distribution of research or a public appearance concerning the effects of "significant news or a significant event on the subject company" during the quiet period. The SRO staffs have interpreted this exception to apply only to news or events that have a material impact on, or cause a material change to, a company's operation, earnings or financial condition. Another exception to the secondary offering quiet period permits publication or distribution of research pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities" as defined in SEC Regulation M.

Recommended Changes

The SRO staffs recommend several changes to the quiet periods surrounding public offerings and lock-up expirations. In some cases, the SRO staffs offer alternative recommendations to address these issues.

(a) Quiet periods following public offerings of securities

The SRO staffs recommend unifying the IPO quiet periods for all underwriters and dealers participating in the offering and tying them to the SEC's rules regarding publication and distribution of research. As such, the SRO staffs recommend amending the rules to apply a 25-day quiet period to managers, co-managers, underwriters and dealers that participate in an IPO, unless publication or distribution of the report or the public appearance is permitted by SEC rule or interpretation.

The lengthier quiet period for managers and co-managers was intended to allow other voices to publicly analyze and value a subject company before managers and co-managers – those members vested with the greatest interest in seeing the stock price of the subject company go up – weighed in with their reports and public appearances. At the time this provision was enacted, it had been commonplace for managers and co-managers to initiate coverage with a positive rating on a company they just brought public, irrespective of whether the stock price had already risen well beyond the public offering price.

However, the SRO staffs recently have observed more circumstances where managers and co-managers have been neutral or even negative with their initial post-quiet period report based on price appreciation or other factors. Accordingly, the SRO staffs believe that the objectivity safeguards of the SRO Rules and the certification requirement of SEC Regulation AC have obviated the need for a longer quiet period for managers and co-managers than other underwriters and dealers participating in an IPO. The SRO staffs also believe the change would promote more information flow to investors and consistency with SEC regulations.

For some of the same reasons, the SRO staffs also recommend eliminating the quiet periods following a secondary offering. Coupled with the protections of SEC Regulation AC and other SRO Rule provisions, the SRO staffs believe that repeal of this provision would advance the SEC's purpose in its Securities Offering Reform rules to expand the ability of issuers to release more information regarding their prospects and financial condition, without sacrificing the reliability of the research. Along those lines, the existing SRO Rules already provide exceptions for research reports on issuers with "actively-traded securities" as defined in SEC Regulation M.

(b) Quiet periods around releases of lock-up agreements

The NASD staff recommends eliminating the quiet periods around the expiration, waiver or termination of a lock-up agreement, provided members include an additional statement as part of their SEC Regulation AC certification – or, alternatively, a separate certification – for research issued during such periods. The quiet periods surrounding lock-up releases are intended to prevent abusive "booster shot" reports by members to raise the stock price of a company just before previously locked-up shares become freely saleable into the market by a company or its major shareholders. While the SRO staffs continue to share the concern expressed by the former

Acting Chair of the SEC¹³⁷ that these periods pose heightened concerns about biased research, the changes to internal structure of investment banks and the other safeguards imposed by the rules appear to the NASD staff to have addressed these concerns, and have obviated the need for a quiet period that inhibits the flow of information to the marketplace. Moreover, the NASD staff believes that practical limitations inhibit effective administration of the provision. Most notably, the SRO Rules do not require lock-up agreements, and the SROs often have no jurisdiction over parties to them, including the subject company and its non-member shareholders. The SROs therefore cannot always be the arbiter of whether certain facts constitute, for example, a waiver or termination of a lock-up – a significant impediment to the SROs' ability to enforce this provision.

The NASD staff notes that under no circumstances are overly optimistic reports acceptable, whether or not they occur around the expiration of a lock-up. To that end, the SRO Rules require a reasonable basis for any recommendation or price target and the valuation method used to determine a price target, while SEC Regulation AC requires certification that any such recommendation or price target be genuinely held. Accordingly, the NASD staff believes an effective alternative to the quiet periods would be to require that members include under Regulation AC, or separately, an additional certification to having a bona fide reason for issuing research within 15 days before and after a lock-up expiration.

On the other hand, the NYSE staff believes that the quiet period surrounding the expiration, termination or waiver of a lock-up agreement should be maintained but perhaps reduced from the current 15-day period to a five-day period. The NYSE staff believes that the regulatory concerns that precipitated the promulgation of the prohibitions are still present. That is, the NYSE staff is concerned that, absent a quiet period around the release of lock-up agreements, member firms may issue "booster shot" reports that are intended to raise the stock price of a company just before locked-up shares become freely saleable into the market by a company or its major shareholders. The NYSE staff believes that, while the certification requirement of SEC Regulation AC may have obviated the need for a longer quiet period for managers and co-managers than other underwriters and dealers participating in an IPO, it does not support the elimination of quiet periods around the release of lock-up agreements.

With respect to operational issues, the NYSE staff observes that the comments and concerns initially made at the time of the rule proposal have not materialized. In this regard, there have not been instances when the NYSE staff has found co-managers to have inadvertently published research in violation of the quiet periods surrounding the waiver of lock-up agreements granted by lead managers.¹³⁸

¹³⁷ Unger Testimony, *supra* note 5, at 229, 235.

¹³⁸ The NYSE/NASD IPO Advisory Committee made the following recommendations: (1) require prospectuses to include a clear description of lock-up agreements and whether the underwriter expects to grant exceptions relating to hedging or other transactions; and (2) require improved disclosure regarding exemptions by an underwriter to an IPO lock-up agreement, by mandating that underwriters notify issuers prior to granting any exemption to a lock-up, and require issuers to file a current report on Form 8-K at least one business day prior to the time the insider commences the transaction, and also that prior to the transaction, the lead underwriter announces the exemption by broad communications to the investment community through a major news service. *See also* Securities Exchange Act Release No. 50896 (Dec. 20,

Moreover, the NYSE staff notes that while the NYSE may not have jurisdiction over some of the participants to such agreements (*e.g.*, the company and its shareholders), it does retain jurisdiction over its member organizations that can issue research and as such can limit the potential for any untoward conduct by maintaining this prohibition.

Lastly, the NYSE staff notes the recent strength of the IPO market¹³⁹ and that such offerings generally contain lock-up agreements. Accordingly, it believes that at this juncture it is appropriate to maintain a form of prohibition absent some compelling empirical data/evidence to the contrary.

(c) *Exceptions to quiet periods*

As noted above, the rules contain an exception that permits publication and distribution of research or a public appearance concerning the effects of “significant news or a significant event on the subject company” during the quiet period. The SRO staffs have interpreted this exception to apply only to news or events that have a material impact on, or cause a material change to, a company’s operations, earnings or financial condition and that generally would trigger the filing requirements of SEC Form 8-K. The SROs have not interpreted the exception to include earnings announcements absent some other significant news or significant event because it was felt that they generally are not a causal event or news items that materially affects a company’s operations, earnings or financial condition.

The NYSE staff believes that exceptions to quiet periods should be consistent with SEC requirements for the filing of Forms 8-K. In this regard, Item 2.02 (Results of Operations and Financial Conditions) of Form 8-K requires, in part, a filing of such form if a registrant makes any public announcement or release (including any update of an earlier announcement or release) disclosing material non-public information regarding its results of operations or financial condition. Accordingly, the NYSE staff recommends including an announcement of earnings as an exception to the quiet periods as it will be consistent with SEC requirements and maintain a flow of potentially sensitive information to the market and investors in a timely manner.¹⁴⁰ The NYSE staff also believes that an announcement of a change to earnings will, in all likelihood, be accompanied by an announcement of some type of causal events. Further, earnings announcements and guidance are necessary pipelines of information for research analysts to support the basis of their investment recommendations.

2004), 69 FR 77804 (Dec. 28, 2004) (notice of filing of proposed NYSE Rule 470 and NASD Rule 2712 which would codify, in part, the above recommendations) (SR-NYSE-2004-12 and SR-NASD-2003-140).

¹³⁹ In 2005, there have been 61 IPOs so far that have listed on the NYSE. In 2004, there were 69 NYSE-listed IPOs. Further, in a recent *Wall Street Journal* article, it was noted that “there are 115 initial public offerings of stock valued at \$20.9 billion waiting to price in the U.S. in 2006, according to data from deal tracker Dealogic LLC.” Lynn Cowan, *IPO Market Looks Strong in 2006*, Wall St. J., Dec. 19, 2005, at C4.

¹⁴⁰ The SEC recognized the importance of timely dissemination of information to the marketplace in its recent amendments to Form 8-K in which it shortened the filing deadline to four business days after the occurrence of an event triggering the disclosure requirements of the form. *See* Securities Act Release No. 8400 and Securities Exchange Act Release No. 49424 (Mar. 16, 2004), 69 FR 15594 (Mar. 25, 2004).

The NASD staff does not believe it is necessary to revise the quiet period exceptions to include any event that triggers the filing of a Form 8-K. The NASD staff continues to believe that earnings announcements are not causal occurrences that, in and of themselves, connote significant news or significant events that materially impact a subject company's financial condition or operations. Moreover, in the NASD staff's experience, abolition of the quiet periods around releases of lock-up agreements would largely obviate the need to expand the "significant news" exception. These issues have arisen mainly because an earnings announcement has occurred or will occur within 15 days of the expiration, waiver or termination of a lock-up agreement. As noted above, the NASD staff further believes that abolition of the quiet periods around releases of lock-up agreements would increase information flow to the marketplace.

6. Restrictions on Personal Trading by Research Analysts

Current Rules

NASD Rule 2711(g) and NYSE Rule 472(e) generally restrict the trading of securities by "research analyst accounts."¹⁴¹ Specifically, NASD Rule 2711(g) and NYSE Rule 472(e) prohibit any research analyst account from:

- purchasing or receiving any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows;
- purchasing or selling any security issued by a company that the research analyst follows, or any option or derivative of such a security, for a period beginning 30 days before and ending five days after the publication of a research report concerning the company or a change in a rating or price target of the company's securities; and
- purchasing or selling any security or option or derivative of such a security in a manner inconsistent with the analyst's most recent recommendation.

The rules include exceptions to these trading restrictions for certain trades that:

- are due to unanticipated significant changes in an analyst's personal financial circumstances;
- occur within the 30-day/five-day trading blackout around the publication of a report if the report is issued due to a significant news event;

¹⁴¹ NASD Rule 2711(a)(6) defines the term "research analyst account" to include any account in which a research analyst or member of the analyst's household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. The term does not include a "blind trust" account that is controlled by a person other than the research analyst or household member and neither the analyst nor any household member knows of the account's investments or investment transactions. Although NYSE Rule 472 does not employ the term "research analyst account," the trading restrictions of NYSE Rule 472(e) and NASD Rule 2711(g) are coterminous. See NYSE Rule 472.40.

- occur within 30 days after an analyst initiates coverage of a company;
- involve shares of diversified registered investment companies; and
- involve interests in an investment fund over which neither the analyst nor a household member has any investment discretion or control, the research analyst accounts collectively own no more than 1% of the fund's assets, and the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies that the analyst follows.

NASD Rule 2711(g) and NYSE Rule 472(e) also require legal or compliance personnel to pre-approve all trades of persons who oversee research analysts to the extent such trades involve equity securities of subject companies covered by the analysts they oversee.

Recommended Changes

Members have suggested the SROs make two principal changes to the personal trading restrictions. First, members have urged the SROs to expand the exceptions to the personal trading restrictions to include any investments in funds not controlled by the research analyst or member of his or her household, regardless of whether the fund is registered as an investment company and regardless of its holdings. Second, some members that wish to go beyond the SRO Rules and ban ownership of securities covered by their analysts have asked the SROs to provide a means for those analysts to divest their holdings without violating the blackout period and trading against recommendation prohibitions.

The SRO staffs generally agree with these comments and therefore recommend the following changes to the exceptions to the SRO Rules' personal trading restrictions.

First, the SRO staffs recommend revising the exceptions to the personal trading restrictions for investment funds. The current rules do not apply the personal trading restrictions to investments in diversified registered investment companies and funds that meet certain percentage-of-assets tests. The SRO staffs recommend that the personal trading restrictions instead not apply to investments in any fund so long as neither the analyst nor a member of his or her household is aware of the fund's holdings or transactions other than through periodic shareholder reports and sales material based on such reports, and provided that the research analyst account owns no more than 1% of the assets of the fund.

This would simplify the ability of analysts to invest in mutual funds, variable insurance products and hedge funds that do not disclose their holdings other than through periodic reports or sales material based on such reports. The SRO staffs believe that absent discretion or control of an account or the contemporaneous knowledge of the account's transactions, a minimal investment by a research analyst will not tempt the analyst to compromise research objectivity to benefit the account.

Second, the SRO staffs recommend creating an exemption for firms that voluntarily choose to prohibit their analysts from owning shares of the companies they cover. The exemption would allow such a firm to adopt policies that permit research analysts to divest their holdings in an

orderly and controlled way with the oversight of the firm's legal and compliance personnel. The SRO staffs permitted firms to allow their analysts to divest their holdings in the same manner when the rule first became effective by delaying for a certain time period implementation of the personal trading restrictions for firms that wished to ban ownership. With the recommended change, the rule would allow firms that adopt ownership bans to implement the same divestiture procedures regardless of when they adopted such a policy.

7. Disclosure Requirements

Current Rules

NASD Rule 2711(h) and NYSE Rule 472(k) impose a number of disclosure requirements on member research reports and research analyst public appearances in which the analyst makes a recommendation or offers an opinion concerning an equity security. The rules require specific disclosures of conflicts of interest, including where the member firm, the research analyst or a member of the analyst's household has a financial interest in the subject company's securities or the member or its affiliates have received compensation from the subject company. The rules also require a number of non-conflicts related disclosures in research reports, including the meanings of ratings used in the member's rating system, the distribution of buy, hold, and sell ratings assigned by the member, and a price chart that plots the assignment or changes of the analyst's ratings and price targets for the subject company against the movement of the subject company's stock price over time.

Recommended Changes

The SRO staffs have found that these required disclosures promote transparency and provide important information to enable investors to assess the value of the research in making their investment decision. However, the SRO staffs are concerned that the sheer volume of the disclosures may obscure the overall message that the disclosures are attempting to convey: that the member or research analyst faces conflicts of interest with respect to the subject company. This problem is compounded by the fact that many members include additional disclosures required by other jurisdictions, as well as sometimes lengthy disclaimers for their own purposes. The SRO staffs believe that it would be more effective and useful to investors to know immediately whether the member firm or research analyst producing the research report is conflicted, while providing the reader the means to learn more about these conflicts if he or she chooses to do so.

To accomplish this result, the SRO staffs recommend amending the rules to require that, in lieu of publication in the research report itself, member firms disclose their conflicts of interest related to research reports by including a prominent warning on the cover of a research report that such conflicts of interest exist, together with information on how the reader may obtain more detail about these conflicts on the member's Web site. A member would then be required to include detailed conflicts information on its Web site. The SRO staffs believe that this disclosure system would be more effective to warn the reader of such conflicts than the current system of disclosing all conflicts in the back of the report.

The SEC has considered using this approach elsewhere to disclose the existence of conflicts of interest to investors. For example, the SRO staffs understand that in its mutual fund point-of-sale disclosure proposal,¹⁴² the SEC staff found that most investors only want to know about whether a conflict exists, rather than receiving quantitative or lengthy disclosure about the precise nature of those conflicts. For that reason, the SEC has proposed requiring a “Yes/No” disclosure of whether a dealer receives revenue sharing or pays differential compensation with respect to the sale of mutual funds. The SEC would require that more detailed disclosure about the nature of any conflicts be provided separately on a mutual fund’s Web site.

Similarly, in commenting on the SEC point-of-sale disclosure proposal, the NASD Mutual Fund Task Force recommended Internet delivery of point-of-sale documents and prospectuses, a recommendation that NASD supports.¹⁴³ The Task Force argued that Internet delivery would enable investors to obtain the level of disclosure that they wanted in electronic form.

The SRO staffs believe that the research analyst conflict of interest rules similarly lend themselves to a more targeted means of disclosure. The SRO staffs therefore suggest amending the SRO Rules to require conflicts of interest disclosure along the lines of the SEC’s point-of-sale proposal and NASD’s Internet delivery recommendations for mutual fund related disclosures. This disclosure requirement would ensure that investors obtain prominent disclosure that a research-related conflict exists, and would permit investors to find additional information about the conflict on the member’s Web site. It is possible that a similar approach could be used for disclosure of conflicts in public appearances, as long as the existence of such conflicts is clearly communicated.

The SRO staffs generally do not believe that vague, so-called “health warnings” that conflicts of interest “may or may not” exist are useful or effective. In this regard, the SRO Rules would still require disclosure based on actual conflicts of interest, rather than the possibility of such conflicts.

The SRO staffs do not recommend Web site disclosure for the non-conflicts related disclosures, such as the meanings of the member’s ratings and the price chart showing the subject company’s price movements against the analyst’s assignments of ratings and price targets. The SRO staffs believe that these disclosures provide useful information that should be readily available to investors, particularly since they would not be encompassed by the recommended conflict warning on the cover of the report.

Finally, the SRO staffs recommend the inclusion of non-substantive, technical changes to certain disclosure requirements in order either to codify past SRO interpretations of the rules or to clarify the rules’ intent. For example, a research report is required to disclose the meanings of ratings used in the member’s ratings system only if the report actually includes a rating of the subject company. Similarly, a price chart is not required for reports that do not include a rating or price target. In addition, the SRO staffs recommend including the disclosure requirements for third-party research reports, which are discussed in NASD *Notices to Members* 02-39 (July

¹⁴² Securites Act Release No. 8544 (Feb. 28, 2005), 70 FR 10521 (Mar. 4, 2005).

¹⁴³ Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 2005), http://www.nasd.com/web/groups/rules_regs/documents/rules_regs/nasdw_013690.pdf.

2002) and 04-18 (Mar. 2004) and NYSE Information Memos 02-26 (June 26, 2002) and 04-10 (Mar. 9, 2004), in the SRO Rules' text.

8. Prohibition on Retaliation Against Research Analysts

Current Rules

The SRO Rules currently prohibit any member and any employee of a member who is involved with the member's investment banking activities from directly or indirectly retaliating against a research analyst as a result of an unfavorable research report or public appearance that may adversely affect the member's current or prospective investment banking relationship with a subject company.

Recommended Changes

The SRO staffs believe that under no circumstances is retaliation appropriate against a research analyst who expresses his or her truly held beliefs about a subject company. As such, the SRO staffs recommend amending this provision to extend the retaliation prohibition to all employees, not just those involved in investment banking activities.

9. Prerequisites for the Research Analyst Qualification Examination

Current Rules

As detailed in Section II, the SRO Rules require an associated person who functions as a research analyst on behalf of a member to register as such and pass the Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption. Prior to taking either the Series 86 or 87, a candidate also must have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative Examination (Series 17), or the Canada Module of Series 7 (Series 37 or 38).

The SRO staffs believe it is important for those functioning as research analysts to be familiar with general industry rules and practices, particularly those of registered representatives, who are a primary source for distributing research. The SRO staffs believe that the topics on the Series 7 and other eligible prerequisite examinations further develop a sensitivity in research analysts to the interests of public customers who are the end users of their work product. The SRO staffs note that a committee of research analysts who were consulted in the development of the Series 86/87 examination program unanimously recommended that research analysts be required to pass the Series 7 in addition to a more job-specific research analyst qualification examination.

Recommended Changes

Several industry members have asked the SROs to consider eliminating the Series 7 or alternative prerequisite exam. These firms argue that research analysts should only be tested on job-specific requirements, and that relevant topics on the Series 7 examination should instead be imported to the Series 86/87 examinations. The SRO staffs recommend considering this suggestion, as well as the possibility of substituting for the Series 7 prerequisite a new Capital Market Professional Examination that is being developed jointly by NASD, the NYSE and

regulators in the United Kingdom. While the content of the latter examination has not yet been precisely determined, it is anticipated that the concepts tested may provide an adequate foundation of general industry rules and practices for research analysts. The SRO staffs will be better situated to evaluate this alternative once the new examination has been fully developed and approved by the SEC.

C. Other Issues

1. Fixed-Income Research

On May 19, 2004, The Bond Market Association (“BMA”) issued its “Guiding Principles to Promote the Integrity of Fixed Income Research,” which are voluntary principles designed to help firms manage potential conflicts of interest that may arise in their fixed-income research activities.¹⁴⁴ According to the BMA, its Guiding Principles were designed to recognize the significant differences between fixed-income research and equity research, as well as the important differences in research regarding individual fixed-income asset classes.

The SRO staffs do not believe it is appropriate at this time to codify any of these principles or amend the SRO Rules to extend their provisions to fixed-income research. Instead, the SROs are monitoring the extent to which firms have adopted the BMA Guiding Principles and will consider further rulemaking after assessing the effectiveness of voluntary compliance. Meanwhile, the SRO staffs believe that the anti-fraud statutes, as well as existing SRO rules, such as NASD Rule 2110’s requirement that members “observe high standards of commercial honor and just and equitable principles of trade” and similar obligations under NYSE Rules 401 and 476(a)(6), can reach any egregious conduct involving fixed-income research.

2. Issuer Retaliation

As noted above, the source of analysts’ conflicts was not limited solely to their investment banking relationships, but also included pressure stemming from issuer retaliation. Issuer retaliation can consist of limiting an analyst’s access to company management or participation in conference calls, and interfering with other company relationships (such as by prohibiting the analyst’s firm from managing an issuer’s pension plan). The SRO Rules have insulated analysts from internal pressures from investment banking personnel by prohibiting retaliation by a member against a research analyst for issuing an unfavorable research report that adversely affects a firm’s investment banking relationship with an issuer. The prohibition against investment banking personnel’s supervising or controlling analysts or participating in the determination of analyst compensation also protects the analyst from retaliation by the investment banking department.

Protection from retaliation by an issuer rather than the investment bank is a more difficult problem to solve. The issue could be addressed through listing standards. However, the NYSE does not believe amendments to its listing standards and its limited ability to enforce such standards by delisting is practicable. In this regard, issuer retaliation, unlike other prohibited

¹⁴⁴ See Guiding Principles To Promote Integrity of Fixed Income Research, May 2004, http://www.bondmarkets.com/assets/files/Guiding_Principles_for_Research.pdf.

firm conduct, is very fact specific, qualitative rather than quantitative in nature and difficult to evaluate and discern with absolute certainty.

Accordingly, the NYSE would like to see the practical impact of the CFA/NIRI “Best Practice Guidelines Governing Analyst/Corporate Issuer Relations” which it has endorsed and communicated to its listed companies.¹⁴⁵ It will continue to monitor the impact of such Best Practices and will continue to engage the SEC in dialogue to explore other practical ways to address this issue.

3. Foreign Regulatory Initiatives

In addition to the SROs, regulators in such jurisdictions as the United Kingdom,¹⁴⁶ Canada,¹⁴⁷ Japan,¹⁴⁸ and Australia¹⁴⁹ have implemented or proposed research analyst conflict of interest rules in some form. Organizations such as the International Organization of Securities Commissions (“IOSCO”) also have issued guidelines and best practices for their members.¹⁵⁰ And the European Union Forum Group (“EU”) released a set of recommendations involving research analyst conflicts to be included in a directive targeting market abuse and promoting uniform regulations among the different European Union securities markets.¹⁵¹

These regulatory models share a common goal of reducing bias in the production and dissemination of research. At the same time, the various initiatives by these regulatory groups demonstrate that there are a number of approaches to eliminating research analyst conflicts: some organizations, like IOSCO and the EU, recommend best practices but do not impose

¹⁴⁵ The NYSE recently issued a letter to its listed companies encouraging them to consider implementing CFA/NIRI Best Practice Guidelines Governing the Relationship between Analysts and Corporate Issuers. *See* letter dated October 11, 2005 from Richard G. Ketchum, Chief Regulatory Officer, NYSE, to Exchange Listed Companies.

¹⁴⁶ Regulations by the Financial Services Authority, “Discussion Paper No. 15” and “Consultation Paper 171,” July 2002 and December 2003, respectively.

¹⁴⁷ Report issued by Securities Industry Committee on Analyst Standards, which was established by the Toronto Stock Exchange, the Investment Dealers Association (“IDA”) and the Canadian Venture Exchange. The report, entitled “Setting Analyst Standards: Recommendations for the Supervision and Practice of Canadian Securities Industry Analysts” was released in November 2001. IDA “Policy 11, Analyst Standards,” was issued in June and December 2002.

¹⁴⁸ Japanese Securities Dealers Association, “Rules for Handling Analysts’ Reports,” January 2002, revised January 2003.

¹⁴⁹ Securities Institute of Australia and the Securities and Derivatives Industry Association, “Best Practices Guidelines for Research Integrity,” November 2001.

¹⁵⁰ IOSCO is an international organization whose members cooperate to promote high standards of regulation to protect investors and ensure that markets are fair, efficient and transparent. In September 2003, the Technical Committee of IOSCO issued a Statement of Principles to guide securities regulators and others in addressing the conflicts of interest securities analysts may face. These principles are combined with certain more specific measures designed to eliminate or manage analysts’ conflicts of interest. The Statement of Principles can be found at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf>.

¹⁵¹ This group issued a Report and the “Market Abuse Directive” to implement a uniform system of regulation to handle market abuses in the European Union. The Market Abuse Directive was first issued in December 2002.

regulations, while the SRO Rules and rules promulgated by the other regulators take a more prescriptive approach. These diverse regulatory models sometimes result in differing requirements that can pose challenges for firms with global research operations.

The SRO staffs support ongoing discussions with their members and international regulatory groups to promote the most effective and efficient means to manage research analyst conflicts of interest and to ensure reliable and objective research throughout the world.

VI. CONCLUSION

The SRO staffs believe that the SRO Rules have been effective in helping to restore integrity to research by minimizing the influences of investment banking and promoting transparency of other potential conflicts of interest. Evidence also suggests that investors are benefiting from more balanced and accurate research to aid their investment decisions. The SRO staffs believe that certain changes to the SRO Rules would further improve their effectiveness by striking an even better balance between ensuring objective and reliable research on the one hand and permitting the flow of information to investors and minimizing costs and burdens to members on the other.

Rule 472. Communications With The Public**Approval of Communications and Research Reports**

(a)(1) Each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member or member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designated under the provisions of Rule 342(b)(1).

(2) Research reports must be prepared or approved, in advance, by a supervisory analyst acceptable to the Exchange under the provisions of Rule 344. Where a supervisory analyst does not have technical expertise in a particular product area, the basic analysis contained in such report may be co-approved by a product specialist designated by the organization. In the event that the member organization has no principal or employee qualified with the Exchange to approve such material, it must be approved by a qualified supervisory analyst in another member organization by arrangement between the two member organizations.

Investment Banking, Research Department and Subject Company Relationships and Communications

(b)(1) Research analysts may not be subject to the supervision, or control, of any employee of the member's or member organization's investment banking department and personnel engaged in investment banking activities may not have any influence or control over the compensatory evaluation of a research analyst.

(2) Research reports may not be subject to review or approval prior to publication by Investment Banking personnel or any other employee of the member or member organization who is not directly responsible for investment research ("non-research personnel") other than Legal or Compliance personnel.

(3) Non-research personnel may review research reports prior to publication only to verify the factual accuracy of information in the research report or to identify any potential conflicts of interest that may exist, provided that:

(i) any written communication concerning the content of research reports between non-research personnel and Research personnel must be made either through Legal or Compliance personnel or in a transmission copied to Legal or Compliance personnel; and

(ii) any oral communication concerning the content of research reports between non-research personnel and Research personnel must be documented and made either with Legal or Compliance personnel acting as intermediary or in a conversation conducted in the presence of Legal or Compliance personnel.

(4) A member or member organization may not submit a research report to the subject company prior to publication, except for the review of sections of a draft of the research report solely to verify facts. Members and member organizations may not, under any circumstances, provide the subject

company sections of research reports that include the research summary, the research rating or the price target.

- (i) Prior to submitting any sections of the research report to the subject company, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.
- (ii) If after submission to the subject company, the Research Department intends to change the proposed rating or price target, the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.
- (iii) The member or member organization may not notify a subject company that a rating will be changed until after the close of trading in the principal market of the subject company one business day prior to the announcement of the change.

(5) A research analyst is prohibited from participating in efforts to solicit investment banking business. This prohibition includes, but is not limited to, participating in meetings to solicit investment banking business (e.g., "pitch" meetings) of prospective investment banking clients, or having other communications with companies for the purpose of soliciting investment banking business. This prohibition shall not apply to any communication between the research analyst, company, and/or non-research personnel, the sole purpose of which is due diligence.

(6)(i) A research analyst is prohibited from directly or indirectly:

- (a) participating in a road show related to an investment banking services transaction; and
- (b) engaging in any communication with a current or prospective customer (s) in the presence of investment banking department personnel or company management about an investment banking services transaction.

(ii) Investment banking department personnel are prohibited from directly or indirectly:

- (a) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and
- (b) directing a research analyst to engage in any communication with a current or prospective customer(s) about an investment banking services transaction.

(iii) Research analyst written and oral communications relating to an investment banking services transaction, with a current or prospective customer(s), or with internal personnel, must be fair, balanced and not misleading, taking into consideration the overall context in which the

communication is made.

Written Procedures

(c) Each member and member organization must establish written procedures reasonably designed to ensure that members, allied members, member organizations and their employees are in compliance with this Rule (see Rule 351(f) and Rule 472(h)(2) for attestations to the Exchange regarding compliance).

Retention of Communications

(d) Communications with the public prepared or issued by a member or member organization must be retained in accordance with Rule 440 ("Books and Records"). The names of the persons who prepared and who reviewed and approved the material must be ascertainable from the retained records and the records retained must be readily available to the Exchange, upon request.

Restrictions on Trading Securities by Associated Persons

(e)(1) No research analyst or household member may purchase or receive an issuer's securities prior to its initial public offering (e.g., so-called pre-IPO shares), if the issuer is principally engaged in the same types of business as companies (or in the same industry classification) which the research analyst usually covers in research reports.

(2) No research analyst or household member may trade in any subject company's securities or derivatives of such securities that the research analyst follows for a period of thirty (30) calendar days prior to and five (5) calendar days after the member's or member organization's publication of research reports concerning such security or a change in rating or price target of a subject company's securities.

(3) No research analyst or household member may effect trades in a manner inconsistent with the research analyst's most current recommendations (i.e., sell securities while maintaining a "buy" or "hold" recommendation, buy securities while maintaining a "sell" recommendation, or effecting a "short sale" in a security while maintaining a "buy" or "hold" recommendation on such security).

(4) Listed below are exceptions to the prohibitions contained in paragraphs (1), (2), and (3) (Each exception granted must be in compliance with policies and procedures adopted by the member or member organization that are reasonably designed to ensure that transactions effected pursuant to these exceptions do not create a conflict of interest between the professional responsibilities and the personal trading activities of the research analyst and/or his or her household member.):

(i) transactions by research analysts and/or household members that have been pre-approved in writing by the Legal or Compliance Department that are made due to an unanticipated significant change in their personal financial circumstances;

(ii) a member or member organization may permit the publication of research reports or permit a change to the rating or price target on a subject company, regardless of whether a research analyst and/or household members traded the subject company's securities or derivatives of such securities, within the thirty (30) calendar day period described in paragraph (e)(2), when the publication of such research reports, or change in such rating or price target is attributable to some significant news or events regarding the subject company, provided that the publication of such research reports, or change in rating or price target on such subject company has been pre-approved in writing by the Legal or Compliance Department;

(iii) sale transactions by a research analyst, who is new to the member or member organization, and/or his or her household members within thirty (30) calendar days of such research analyst's employment with the member or member organization when such research analyst and/or household members had previously purchased such security or derivatives of such security prior to the research analyst's employment with the member or member organization;

(iv) sale transactions by a research analyst and/or household member within thirty (30) calendar days from the date of the member's or member organization's publication of research reports or changes to the rating or price target on a subject company when such research analyst and/or household members had previously purchased the subject company's securities or derivatives of such securities prior to initiation of coverage of the subject company by the research analyst;

(v) transactions in accounts not controlled by the research analyst and for investment funds in which a research analyst or household member has no investment discretion or control, provided the interest of the research analyst or household member in the assets of the fund does not exceed 1% of the fund's assets, and the fund does not invest more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies (or in the same industry classification) which the research analyst usually covers in research reports. If an investment fund distributes securities in kind to a research analyst before the issuer's initial public offering, the research analyst must either divest those securities immediately or refrain from participating in the preparation of research reports concerning that issuer;

(vi) transactions in a registered diversified investment company as defined under Section 5(b)(1) of the Investment Company Act of 1940.

(5) No person who supervises research analysts (e.g., Director of Research), a Supervisory Analyst, or a member of a committee, who has direct influence and/or control with respect to (1) preparing the substance of research reports, or (2) establishing or changing a rating or price target of a subject company's equity securities, may effect trades in securities of companies that are the subject of such research reports, or ratings or price target changes, without the prior approval of the Legal or Compliance personnel of the member or member organization.

(6) Members and member organizations must maintain written records for each transaction and the justification for permitting such transactions for three years following the date the transactions were made pursuant to the exceptions provided for in Rule 472(e)(4)(i)-(iv), and (5).

Restrictions on Member's or Member Organization's Issuance of Research Reports and Participation in Public Appearances

(f)(1) A member or member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member or member organization acted as manager or co-manager of an initial public offering within forty (40) calendar days following the offering date.

(2) A member or member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member or member organization acted as manager or co-manager of a secondary offering within ten (10) calendar days following the offering date. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(3) No member or member organization that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report regarding that issuer and a research analyst may not recommend or offer an opinion on that issuer's securities in a public appearance for twenty-five (25) calendar days following the offering date.

(4) No member or member organization which has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance within fifteen (15) days prior to or after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member or member organization has entered into with a subject company and its shareholders that restricts or prohibits the sale of the subject company's or its shareholders' securities after the completion of a securities offering. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(5) A member or member organization may permit exceptions to the prohibitions in paragraphs (f)(1), (2), and (4) (consistent with other securities laws and rules) for research reports that are published or otherwise distributed or recommendations or opinions on an issuer's securities made in a public appearance due to significant news or events, provided that such research reports are pre-approved in writing by the

member's or member organization's Legal or Compliance personnel.

(6) If a member or member organization intends to terminate its research coverage of a subject company, notice of this termination must be made. The member or member organization must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is impracticable for the member or member organization to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the employ of the member or member organization, or where the member or member organization terminates coverage on the industry or sector). In instances where it is impracticable for the member or member organization to provide a final recommendation or rating, the member or member organization must provide the rationale for the decision to terminate coverage.

Prohibition of Offering Favorable Research for Business

(g)(1) No member or member organization may directly or indirectly offer a favorable research rating or specific price target, or offer to change a rating or price target, to a subject company as consideration or inducement for the receipt of business or for compensation.

(2) No member or member organization and no employee of a member or member organization who is involved with the member's or member organization's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or member organization or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report written or public appearance made by the research analyst that may adversely affect the member's or member organization's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's or member organization's authority to discipline or terminate a research analyst, in accordance with the member's or member organization's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such unfavorable public appearance.

Restrictions on Compensation to Research Analysts

(h)(1) No member or member organization may compensate a research analyst for specific investment banking services transactions. A research analyst may not receive an incentive or bonus that is based on a specific investment banking services transaction. However, a member or member organization is not prohibited from compensating a research analyst based upon such member's or member organization's overall performance (see Rule 472(k)(1)(ii)a.2. for disclosure of such compensation).

(2) The compensation of a research analyst primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee which reports to the Board of Directors or, where the member or member organization has no Board of

Directors, to a senior executive officer of the member or member organization. Such committee may not include representatives from the member's or member organization's Investment Banking Department. The committee must, among other things, consider the following factors, if applicable, when reviewing such research analyst's compensation:

- i. The research analyst's individual performance, (e.g., productivity, and quality of research product);
- ii. The correlation between the research analyst's recommendations and stock price performance;
- iii. The overall ratings received from clients, sales force, and peers independent of the Investment Banking Department, and other independent rating services.

The committee may not consider as a factor in reviewing and approving such research analyst's compensation, his or her contributions to the member's or member organization's investment banking business.

The committee must document the basis upon which such research analyst's compensation was established. The annual attestation required by Rule 351(f) must certify that the committee reviewed and approved the compensation for each research analyst primarily responsible for the preparation of the substance of a research report and has documented the basis upon which such compensation was established.

General Standards for All Communications

(i) No member or member organization shall utilize any communication which contains (i) any untrue statement or omission of a material fact or is otherwise false or misleading; or (ii) promises of specific results, exaggerated or unwarranted claims; or (iii) opinions for which there is no reasonable basis; or (iv) projections or forecasts of future events which are not clearly labeled as forecasts.

Specific Standards for Communications

(j)(1) Recommendations

A recommendation (even though not labeled as a recommendation) must have a basis which can be substantiated as reasonable.

When recommending the purchase, sale or switch of specific securities, supporting information must be provided or offered.

The market price at the time the recommendation is made must be indicated.

(2) Records of Past Performance

Communications may feature record or statistics which portray the

performance of past recommendations or of actual transactions of the member organization provided that the following conditions are met:

- (i) The portrayal is balanced and consists of records or statistics that are confined to a specific "universe" that can be fully isolated and circumscribed and that covers at least the most recent 12-month period.
- (ii) The communications include the date and price of each initial recommendation or transaction and the date and price of the recommendation or transaction at the end of the period or when liquidation was suggested or effected, whichever was earlier. Communications may also present summarized or averaged records of statistics or otherwise offer the complete record rather than provide it. This material must include the total number of items recommended or transacted, the number that advanced and declined and an offer to provide the complete record upon request.
- (iii) The communications disclose the existence of all relevant costs, including commissions and interest charges or other applicable expenses and, whenever annualized rates of return are used, all material assumptions used in the process of annualization.
- (iv) An indication is provided of the general market conditions during the period covered, and any comparison made between such records and statistics and an overall market (e.g., comparison to an index) is valid.
- (v) The communications state that the results presented should not and cannot be viewed as an indicator of future performance.
- (vi) All the original recommendations or evidence of actual transactions on which the record is based are retained for three years by the organization and made available to the Exchange on request.

(3) Projections and Predictions

Any projection or prediction must contain the bases or assumptions upon which they are made and must indicate that the bases or assumptions of the materials upon which such projections and predictions are made are available upon request.

(4) Comparisons

Any comparison of one member organization's service, personnel, facilities or charges with those of other firms must be factually supportable.

(5) Dating Reports

All communications must be appropriately dated. Any significant information that is not reasonably current (usually more than 6 months old—depending upon the industry and circumstances) must be noted.

(6) Identification of Sources

Communications not prepared under the direct supervision of the member organization or its correspondent member organization should show the person (by name and appropriate title) or outside organization which prepared the material.

In distributing communications prepared under the direct supervision of a correspondent member organization, the distributing firm should mention this fact, although it may not be necessary to identify the correspondent by name.

Communications about a corporate issuer which are distributed by a member organization but have been prepared and published by the issuer or for the issuer by a party other than the member organization should clearly identify the preparer and publisher.

(7) Testimonials

In testimonials concerning the quality of a firm's investment advice, the following points must be clearly stated in the communication:

- (i) The testimonial may not be representative of the experience of other clients.
- (ii) The testimonial is not indicative of future performance or success.
- (iii) If more than a nominal sum is paid, the fact that it is a paid testimonial must be indicated.
- (iv) If the testimonial concerns a technical aspect of investing, the person making the testimonial must have knowledge and experience to form a valid opinion.

Disclosure

(k)(1) Disclosures Required in Research Reports

Disclosure of Member's, Member Organization's, and Research Analyst's Ownership of Securities, Receipt of Compensation, and Subject Company Relationships

The front page of a research report either must include the disclosures required under this Rule or must refer the reader to the page(s) on which each such disclosure is found. Disclosures, and references to disclosures, must be clear, comprehensive, and prominent.

- (i) A member or member organization must disclose in research reports:
 - a. if the member or member organization or its affiliates:
 - 1. has managed or co-managed a public offering of securities for the subject company in the past twelve (12) months;

2. has received compensation for investment banking services from the subject company in the past twelve (12) months; or

3. expects to receive or intends to seek compensation for investment banking services from the subject company in the next three (3) months.

b. if the member or member organization is making a market in the subject company's securities at the time the research report is issued;

c. if, as of the last day of the month immediately preceding the date the publication (or the end of the second most recent month if the publication is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

d. if, as of the last day of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than thirty (30) calendar days after the end of the most recent month):

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of distribution of the research report (In such instances, the member or member organization also must disclose the types of services provided to the subject company. For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);

2. the member or member organization received any compensation for products or services other than for investment banking services from the subject company in the past twelve (12) months.

e. the valuation methods used, and any price objectives must have a reasonable basis and include a discussion of risks;

f. the meanings of all ratings used by the member or member organization in its ratings system (For example, a member or member organization might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next twelve (12)-month period. Definitions of ratings terms also must be consistent with their plain meaning. Therefore, for example, a "hold" rating should not mean or imply that an investor should sell a security.);

g. the percentage of all securities that the member or member organization

recommends an investor "buy," "hold," or "sell." Within each of the three (3) categories, a member or member organization must also disclose the percentage of subject companies that are investment banking services clients of the member or member organization within the previous twelve (12) months (see Rule 472.70 for further information);

h. a chart that depicts the price of the subject company's stock over time and indicates points at which a member or member organization assigned or changed a rating or price target. This provision would apply only to securities that have been assigned a rating for at least one (1) year, and need not extend more than three (3) years prior to the date of the research report. The information in the price chart must 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 fifteen (15) calendar days after the most recent calendar quarter).

(ii) A member or member organization must include the following disclosures in research reports:

a. if a research analyst received any compensation:

1. from the subject company in the past twelve (12) months;
2. that is based upon (among other factors) the member's or member organization's overall investment banking revenues.

b. if, to the extent the research analyst or an employee of the member or member organization with the ability to influence the substance of a research report, knows:

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of distribution of the research report. In such instances, such member or member organization also must disclose the types of services provided to the subject company (For purposes of paragraph (k)(1) of this Rule, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.). (For purpose of paragraph (k)(1) of this Rule, an employee of a member or member organization with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.);
2. that the member, member organization or any affiliate thereof, received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months.

(iii) A research analyst and a member or member organization must disclose in research reports:

a. if, to the extent the research analyst or member or member organization has reason to know, an affiliate of the member or member organization received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months;

1. This requirement will be deemed satisfied if such compensation is disclosed in research reports within thirty (30) days after completion of the most recent calendar quarter, provided that the member or member organization has taken steps reasonably designed to identify such compensation during that calendar quarter.
2. The member or member organization and the research analyst will be presumed not to have reason to know whether an affiliate received compensation for other than investment banking services from the subject company in the past twelve (12) months if the member or member organization maintains and enforces policies and procedures reasonably designed to prevent all research analysts and employees of the member or member organization with the ability to influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning such compensation.
3. Paragraph 472(k)(1)(iii)a. shall not apply to any subject company as to which the member or member organization initiated coverage since the beginning of the current calendar quarter.

b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;

c. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;

d. any other actual, material conflict of interest of the research analyst, or member or member organization, of which the research analyst knows, or has reason to know, at the time the research report is published or otherwise distributed.

When a member or member organization publishes or otherwise distributes a research report covering six (6) or more subject companies for purposes of the disclosures required in paragraph (k)(1) of this Rule, such research report may direct the reader in a clear and prominent manner as to where the reader may obtain applicable current disclosures in written or electronic format.

(k)(2) Disclosures Required in Public Appearances

Disclosure of Member's, Member Organization's, and Research Analyst's Ownership of Securities, Receipt of Compensation, and Subject Company Relationships

- (i) A research analyst must disclose in public appearances:

a. if, as of the last day of the month before the appearance (or the end of the second most recent month if the appearance is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;

c. if, to the extent the research analyst knows or has reason to know:

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of the public appearance by the research analyst. In such instances, the research analyst also must disclose the types of services provided to the subject company (For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);

2. the member or member organization or any affiliate thereof, received any compensation from the subject company in the past twelve (12) months.

d. any other actual, material conflict of interest of the research analyst, or member or member organization, of which the research analyst knows, or has reason to know, at the time the public appearance is made;

e. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;

f. if the research analyst received any compensation from the subject company in the past twelve (12) months.

(k)(3) Exceptions to the Required Disclosures

(i) A member or member organization or a research analyst will not be required to make a disclosure required by Rule 472(k)(1)(i)a.2. and 3., (k)(1)(i)d.1., (k)(1)(ii)b.1., and (k)(2)(i)c. to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company.

Other Communications Activities

(l) Other communications activities are deemed to include, but are not limited to, conducting interviews with the media, writing books, conducting seminars or lecture courses, writing newspaper or magazine articles, or making radio/TV appearances.

Members and member organizations must establish specific written supervisory procedures applicable to members, allied members, and employees who engage in these types of communications activities. These procedures must include provisions that require prior approval of such activity by a person designated under the provisions of Rule 342(b)(1). These types of activities are subject to the general standards set forth in paragraph (i). In addition, any activity which includes discussion of specific securities is subject to the specific standards in paragraph (j).

Small Firm Exception

(m) The provisions of Rule 472(b)(1), (2) and (3) do not apply to members and member organizations that over the three previous years, on average per year, have participated in ten (10) or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph, the term "investment banking services transactions" shall include both debt and equity underwritings but not municipal securities underwritings. Members and member organizations that qualify for this exemption must maintain records for three (3) years of any communications that, but for this exemption, would be subject to paragraphs (b)(1), (2), and (3) of this Rule.

• • • **Supplementary Material:** -----

.10 Definitions

(1) **Communication**—The term "Communication" is deemed to include, but is not limited to advertisements, market letters, research reports, sales literature, electronic communications, communications in and with the press and wires and memoranda to branch offices or correspondent firms which are shown or distributed to customers or the public.

(2) **Research Report**— "Research report" is generally defined as a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and provides information reasonably sufficient upon which to base an investment decision.

For purposes of approval by a supervisory analyst pursuant to Rule 472 (a)(2), the term research report includes, but is not limited to, a report which recommends equity securities, derivatives of such securities, including options, debt and other types of fixed income securities, single stock futures products, and other investment vehicles subject to market risk.

(3) **Advertisement**— "Advertisement" is defined to include, but is not limited to, any sales communications that is published, or designed for

use in any print, electronic or other public media such as newspapers, periodicals, magazines, radio, television, telephone recording, web sites, motion pictures, audio or video device, telecommunications device, billboards or signs.

(4) **Market letters**— "Market letters" are defined as, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles that are not defined as research reports. They also may include "follow-ups" to research reports and articles prepared by members or member organizations which appear in newspapers and periodicals.

(5) **Sales literature**— "Sales literature" is defined as, but is not limited to, written or electronic communications including, but not limited to, telemarketing scripts, performance reports or summaries, form letters, seminar texts, and press releases discussing or promoting the products, services, and facilities offered by a member or member organization, the role of investment in an individual's overall financial plan, or other material calling attention to any other communication.

.20 For purposes of this Rule, "investment banking services" includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

.30 For purposes of this Rule, the term "Investment Banking Department" means any department or division of the member or member organization, whether or not identified as such, that performs any investment banking services on behalf of the member or member organization.

.40 For purposes of this Rule, the term "research analyst" includes a member, allied member, associated person or employee of a member or member organization primarily responsible for, and any person who reports directly or indirectly to such research analyst in connection with, the preparation of the substance of a research report whether or not any such person has the job title of "research analyst".

For purposes of this Rule, the term "household member" means any individual whose principal residence is the same as the research analyst's principal residence. Paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v), (k)(1)(iii)b., c., and (k)(2)(i)b. and e. apply to any account in which a research analyst has a financial interest, or over which the research analyst exercises discretion or control, other than an investment company registered under the Investment Company Act of 1940. The trading restrictions applicable to research analysts and household members (i.e., paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v); do not apply to a "blind trust" account that is controlled by a person other than the research analyst or research analyst's household member where neither the research analyst nor household member knows of the account's investments or investment transactions.

.50 For purposes of this Rule, the term "public appearance" includes,

without limitation, participation by a research analyst in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or public speaking activity, or the writing of a print media article in which such research analyst makes a recommendation or offers an opinion concerning any equity securities.

.60 For purposes of this Rule, "subject company" is the company whose equity securities are the subject of a research report or a public appearance.

.70 For purposes of Rule 472(k)(1)(i)(h), a member or member organization must determine, based on its own ratings system, into which of the three (3) categories each of their securities ratings utilized falls. This information must 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 fifteen (15) calendar days after the most recent calendar quarter). For example, a research report might disclose that the member or member organization has assigned a "buy" rating to 58% of the securities that it follows, a "hold" rating to 15%, and a "sell" rating to 27%.

Rule 472(k)(1)(i)h. requires members or member organizations to disclose the percentage of companies that are investment banking services clients for each of the three (3) ratings categories within the previous twelve (12) months. For example, if twenty (20) of the twenty-five (25) companies to which a member or member organization has assigned a "buy" rating are investment banking clients of the member or member organization, the member or member organization would have to disclose that 80% of the companies that received a "buy" rating are its investment banking clients. Such disclosure must be made for the "buy," "hold" and "sell" ratings categories as appropriate.

.80 For purposes of this Rule, the term "Legal or Compliance Department" also includes, but is not limited to, any department of the member or member organization which performs a similar function.

.90 For purposes of Rule 472(a)(1), a qualified person is one who has passed an examination acceptable to the Exchange.

.100 For purposes of this Rule, the term "initial public offering" refers to the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement.

.110 For purposes of this Rule, a secondary offering shall include a registered follow-on offering by an issuer or a registered offering by persons other than the issuer involving the distribution of securities subject to Regulation M of the Securities Exchange Act of 1934.

.120 For purposes of this Rule, the term "offering date" refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

.130 For purposes of this Rule, the term associated person is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member or member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.

Amended: October 20, 1955, effective November 1, 1955; September 19, 1963, effective October 15, 1963; June 18, 1964; March 26, 1970; February 2, 1977; December 14, 1983; December 31, 1997; March 19, 1990; May 10, 2002 effective July 9, 2002 (NYSE-2002-09); July 29, 2003 (NYSE-2002-49); April 14, 2005 (NYSE-2005-24); April 21, 2005 (NYSE-2004-24).

Rule 472 COMMUNICATIONS WITH THE PUBLIC

(k)(2) Disclosure Required in Public Appearances

/01 Public Appearances – Print Media

When a research analyst recommends securities in a print or broadcast media interview, newspaper article or other type of public medium all of the disclosures required under Rule 472(k)(2) are required to be provided to the media outlet for inclusion in the published interview, article, broadcast, or other medium.

Whenever a research analyst recommends securities in a print media interview, newspaper article prepared under his or her name, or broadcast, a record of such interview, article or broadcast must be made within forty-eight (48) hours of such interview, article or broadcast. Such record must be prepared by the research analyst, Legal or Compliance personnel or Research Department management.

Such record must include, at minimum, the name of the research analyst(s), the name of the publication, the date of the interview, article, or broadcast the name of the interviewer (if applicable), the name(s) of the securities recommended and the specific disclosures provided to the print or broadcast media source and/or interviewer. Such record must be made regardless of whether the media outlet published or broadcast the required disclosures. The research analyst's member or member organization must retain the record of such interview, article, or broadcast and the disclosures made in a manner consistent with Rule 17a-4 of the Securities Exchange Act of 1934. The record retained must be readily available to the Exchange, upon request.

Rule 351. Reporting Requirements

(a) Each member not associated with a member organization and each member organization shall promptly report to the Exchange whenever such member or member organization, or any member, allied member or registered or non-registered employee associated with such member or member organization:

(1) has violated any provision of any securities law or regulation, or any agreement with or rule or standards of conduct of any governmental agency, self-regulatory organization, or business or professional organization, or engaged in conduct which is inconsistent with just and equitable principles of trade or detrimental to the interests or welfare of the Exchange;

(2) is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery;

(3) is named as a defendant or respondent in any proceeding brought by a regulatory or self-regulatory body alleging the violation of any provision of the Securities Exchange Act of 1934, or of any other Federal or state securities, insurance, or commodities statute, or of any rule or regulation thereunder, or of any agreement with, or of any provision of the constitution, rules or similar governing instruments of, any securities, insurance or commodities regulatory or self-regulatory organization;

(4) is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry regulatory or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member or member organization of any such self-regulatory organization;

(5) is arrested, arraigned, indicted or convicted of, or pleads guilty to, pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in a domestic, military or foreign court;

(6) is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company which was suspended, expelled or had its registration denied or revoked by any agency, jurisdiction or organization or is associated in such a capacity with a bank, trust company or other financial institution which was convicted of, or pleaded no contest to, any felony or misdemeanor;

(7) is a defendant or respondent in any securities or commodities-related civil litigation or arbitration which has been disposed of by judgment, award or settlement for an amount exceeding \$15,000. However, when a member organization is the defendant or respondent, then the reporting to the

Exchange shall be required only when such judgment, award or settlement is for an amount exceeding \$25,000;

(8) is the subject of any claim for damages by a customer, broker or dealer which is settled for an amount exceeding \$15,000. However, when the claim for damages is against a member organization, then the reporting to the Exchange shall be required only when such claim is settled for an amount exceeding \$25,000;

(9) is, or learns that he is associated in any business or financial activity with any person who is, subject to a "statutory disqualification" as that term is defined in the Securities Exchange Act of 1934.

(10) is the subject of any disciplinary action taken by the member or member organization against any of its associated persons involving suspension, termination, the withholding of commissions or imposition of fines in excess of \$2,500, or any other significant limitation on activities.

(b) Each member associated with a member organization and each allied member or registered or non-registered employee of a member or member organization shall promptly report the existence of any of the conditions set forth in paragraph (a) of this rule to the member or member organization with which such person is associated.

(c) Each approved person shall promptly report to the member organization with which such approved person is associated, whenever such approved person becomes subject to a statutory disqualification as defined in the Securities Exchange Act of 1934; and upon being so notified, or otherwise learning such fact, the member or member organization shall promptly so advise the Exchange in writing, giving the name of the person subject to the statutory disqualification and details concerning the disqualification.

(d) At such intervals and in such detail as the Exchange shall specify, each member not associated with a member organization and each member organization shall report to the Exchange statistical information regarding customer complaints relating to such matters as may be specified by the Exchange. For the purpose of this paragraph (d), "customer" includes any person other than a broker or dealer.

(e) Each member not associated with a member organization and a senior officer or partner of each member organization shall take one or both of the following two actions in relation to the trades that are subject to the review procedures required by Rule 342.21(a):

(i) Sign a written statement in the form specified below and deliver it to the Exchange by the 15th day of the month following the calendar quarter in which the trade occurred, and

(ii) As to any such trade that is the subject of an internal investigation pursuant to Rule 342.21(b), but has not been both resolved and included in the written statement made pursuant to subparagraph (i) above, report in writing to the Exchange:

- (A) The commencement of the internal investigation, the identity of the trade and the reason why the trade could not be the subject of a written statement made pursuant to subparagraph (i) above (report by the 15th day of the month, following the calendar quarter in which the trade occurred).
- (B) The quarterly progress of each open investigation (report by the 15th day of the month following the quarter).
- (C) The completion of the investigation, detailing the methodology and results of the investigation, any internal disciplinary action taken, and any referral of the matter to the Exchange, another self-regulatory organization, the Securities and Exchange Commission or another Federal agency; and including, where no internal disciplinary action has been taken and no such referral has been made, a written statement in relation to the trade in the form specified below (report within one week after completion of the investigation).

The statement that subparagraph (i) requires shall read substantially as follows:

- (1) [I/NAME OF MEMBER ORGANIZATION] [have/has] established procedures for reviewing the facts and circumstances surrounding trades in NYSE listed securities and related financial instruments for [my/the] account [of NAME OF MEMBER ORGANIZATION] ("Proprietary Trades") and for the accounts of [my/its] [members, allied members and] employees and their family members, including trades reported by other members or member organizations pursuant to Rule 407, ("Employee Trades"), which procedures [I/NAME OF MEMBER ORGANIZATION] [have/has] determined to be reasonably designed to identify trades that may violate the provisions of the Securities Exchange Act of 1934, the rules under that act or the rules of the Exchange prohibiting insider trading and manipulative and deceptive devices,
- (2) I, my designees or the senior supervisors responsible for particular activities have carried out those procedures in relation to Proprietary Trades and Employee Trades effected during the [ORDINAL NUMBER] quarter of [YEAR], and
- (3) Based upon my assessment of the adequacy of those procedures and of the diligence of those carrying out those procedures, and except as to those Proprietary Trades and Employee Trades that I have reported to the Exchange pursuant to Rule 351(e)(ii) as the subject of internal investigation, I have no reasonable cause to believe that: (a) any one or more of the Proprietary Trades effected during the period referred to in clause (2) above, or (b) any one or more of the Employee Trades both effected during that period and reviewed under those procedures violated the provisions of the Securities Exchange Act of 1934, the rules under the act or the rules of the Exchange prohibiting insider trading and manipulative and deceptive devices.

When a statement pertains to one or more trades that have been the subject of an internal investigation pursuant to Rule 342.21(b) but as to

which no internal disciplinary action has been taken and no referral of the matter to the Exchange, to another self-regulatory organization or to a Federal agency has been made, the statement that subparagraph (ii) (C) requires shall be as above, except that it shall refer to the particular trade (s) (rather than to the trades of a particular calendar quarter) and shall omit the clause excepting trades reported as the subject of an investigation. For the purpose of this paragraph (e), a "senior officer or partner" means (i) the chief executive officer or managing partner or

(ii) either (A) any other officer or partner who is a member of the member organization's executive or management committee or its equivalent committee or group or (B) if the member organization has no such committee or group, any officer or partner having senior executive or management responsibility who reports directly to the Chief Executive Officer or managing partner. If, in the case of a member organization, its chief executive officer or managing partner does not sign the statement, a copy of the statement shall be provided to the chief executive officer or managing partner.

(f) Each member and member organization that prepares, issues or distributes research reports or whose research analysts make public appearances is required to submit to the member's or member organization's Designated Examining Authority, annually, a letter of attestation signed by a senior officer or partner that the member or member organization has established and implemented procedures reasonably designed to comply with the provisions of Rule 472. The attestation must also specifically certify that each research analyst's compensation was reviewed and approved in accordance with the requirements of Rule 472(h) (2) and that the basis for such approval has been documented.

Amended: March 16, 1972; February 15, 1979; March 26, 1980; May 27, 1988; March 22, 1990; May 3, 2002; July 9, 2002 (2002-09); July 29, 2003 (NYSE-2002-49).

• • • Supplementary Material: -----

.10 Any report required pursuant to paragraphs (a), (b) or (d) of this Rule 351 shall be submitted to the Exchange on a form or forms prescribed by the Exchange.

Adopted: February 15, 1979.

Amended: May 27, 1988.

.11 For purposes of Rule 351(f), the attestation must be submitted by April 1 of each year.

Adopted: July 9, 2002 (2002-09).

.12 The term "research report" is defined in Rule 472.10 and the term "public appearance" is defined in Rule 472.50.

Adopted: July 9, 2002 (2002-09).

Amended: July 29, 2003 (NYSE-2002-49).

Rule 344. Research Analysts and Supervisory Analysts

Research analysts and supervisory analysts must be registered with, qualified by, and approved by the Exchange.

Adopted: June 18, 1964.

• • • Supplementary Material: -----

.10 For purposes of this Rule, the term "research analyst" includes a member, allied member, associated person or employee who is primarily responsible for the preparation of the substance of a research report and/or whose name appears on such report. Such research analysts must pass a qualification examination acceptable to the Exchange.

.11 For purposes of this Rule, the term "supervisory analyst" includes a member, allied member, or employee who is responsible for preparing or approving research reports under Rule 472(a)(2). In order to show evidence of acceptability to the Exchange as a supervisory analyst, a member, allied member, or employee may do one of the following:

(1) Present evidence of appropriate experience and pass an Exchange Supervisory Analyst Examination (Series 16).

(2) Present evidence of appropriate experience and successful completion of a specified level of the Chartered Financial Analysts Examination prescribed by the Exchange and pass only that portion of the Exchange Supervisory Analyst Examination (Series 16) dealing with Exchange rules on research standards and related matters.

The Exchange publishes a Study Outline for the Research Analyst Examination and the Supervisory Analyst Examination (Series 16).

.12 For purposes of this Rule, the term "associated person" is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member or member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.

Amended: October 4, 1973; March 10, 1983; July 29, 2003 (NYSE-2002-49); February 23, 2005 (NYSE-2005-12); April 14, 2005 (NYSE-2005-24).

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/01

Research AnalystsQualifications

Research Analyst candidates shall qualify by taking the Research Analyst Qualification Examination (Series 86/87). For purposes of this interpretation, the term “research analyst” is defined in Rule 344.10. The Series 86 covers security analysis and valuation of equity securities. The Series 87 covers pertinent rules and regulations of the self-regulatory organizations, and the SEC.

Prerequisite

The General Securities Registered Representative Examination (Series 7) qualification is a prerequisite for any Research Analyst candidate prior to taking either Part I (Series 86) or Part II (Series 87) of the Research Analyst Qualification Examination.

Alternatively, the United Kingdom Limited Registered Representative (Series 17) Examination and the Canadian Limited Registered Representative (Series 37/38) Examination will also serve as prerequisites to taking either Part I or Part II of the Research Analyst Qualification Examination.

In satisfying the Series 7, Series 17 or Series 37/38 examination prerequisite, Research Analyst candidates will not be required to complete the four-month training period required of Registered Representative candidates nor do they have to be approved by the Exchange pursuant to Rule 345.15/02 (see page 3459).

Candidates that have failed either Part I or II of the Research Analyst Qualification Examination must wait 30 days before retaking either part of the examination.

NYSE Rule 344/01

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/01

Qualifications (continued)Exemptions

Successful completion of Levels I and II of the Charter Financial Analyst ("CFA") Examination administered by the CFA Institute allows a Research Analyst candidate to request an exemption from Part I (Series 86) of the Research Analyst Qualification Examination. If an exemption is granted for Part I (Series 86), a candidate will be qualified as a Research Analyst after passing Part II (Series 87) and the prerequisite examination (i.e., Series 7, 17, or 37/38 examinations).

Successful completion of Levels I and II of the Chartered Market Technician Program ("CMT") administered by the Market Technician Association ("MTA") allows a Research Analyst candidate who prepares only technical research reports to request an exemption from Part I (Series 86) of the Research Analyst Qualification Examination. If an exemption is granted for Part I (Series 86), a candidate will be qualified as a Research Analyst only after passing Part II (Series 87) and the prerequisite examination (i.e., Series 7, 17, or 37/38 examinations).

To qualify for a CFA or CMT exemption a Research Analyst candidate must have: (i) completed the CFA Level II or CMT Level II within two years of application for registration or (ii) functioned as a research analyst continuously since having passed the CFA Level II or CMT Level II. Applicants that have completed the CFA Level II or CMT Level II that do not meet criteria (i) or (ii) may where good cause is shown based upon previous related employment experience make a written request to the Exchange for an exemption.

A technical research report is a research report as defined in Rule 472.10(2) that is based solely on stock price movement and trading volume and not on the subject company's financial information, business prospects, contact with the subject company's management, or the valuation of a subject company's securities.

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/02

Foreign Research Analysts

Exemption

The requirement that a research analyst as defined under NYSE Rule 344.10 must be registered with, qualified by and approved by the Exchange shall not apply where such analyst is an associated person of a member or member organization who is an employee of a non-member foreign affiliate of such member or member organization who contributes to the preparation of the member's or member organizations research reports ("foreign research analyst"), provided the following conditions are satisfied:

- The foreign research analyst resides and is employed in a jurisdiction that the NYSE has determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with NYSE Rule 344 and the research analyst conflicts of interest provisions pursuant to NYSE Rule 472;
- The foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdictions in which the foreign research analyst resides and is employed;
- Members and member organizations have imposed on affiliates that employ foreign research analysts, and the foreign research analysts all research-related standards that the member or member organization imposes on its research reports and research analysts, including the provisions of NYSE Rule 472;
- Members, member organizations and their affiliates that distribute research reports partially or entirely prepared by a foreign research analyst must subject such research reports to pre-use review and approval by a supervisory analyst, as required by NYSE Rule 472;

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/02

Foreign Research Analysts (continued)

- The annual attestation required under NYSE Rule 351(f) must include the global application of NYSE Rule 472 to foreign affiliates that employ foreign research analysts; and
- In addition to the disclosure requirements of NYSE Rule 472, each research report must include a disclosure on the front page stating that:

“This research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member or member organization. These research analysts are not registered/qualified as a research analyst with the NYSE and/or NASD, but instead have satisfied the registration/qualification requirements or other research-related standards of a foreign jurisdiction that have been recognized for these purposes by the NYSE and NASD.”

Disclosure on the front page of each research report must identify:

- (1) each affiliate contributing to the research report;
- (2) the location of such affiliate; and
- (3) the names of the foreign research analysts employed by each contributing affiliate.

The cover page must also contain general disclosure language describing the relationship between the contributing affiliates and the member or member organization.

NYSE Rule 344/02

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS/02 Foreign Research Analysts (continued)

The front page of the research report must also refer to a separate "Foreign Affiliate Disclosures" section (similar to the "Required Disclosure" section currently mandated by the NYSE and NASD under Rules 472 and 2711 respectively) located in close proximity to the "Required Disclosure" section.

In this disclosure section, the member or member organization must disclose the following:

- (1) information on the nature of the affiliation with the affiliate;
- (2) each affiliate's address; and
- (3) the primary regulator in the jurisdiction(s) in which each affiliate is located.

Record Keeping

Members and member organization must establish and maintain records that identify those individuals who have availed themselves of this exemption, the basis for such exemption, and evidence of compliance with the conditions of the exemption.

/03 Supervisory AnalystsQualifications

Supervisory Analyst candidates shall qualify by taking and passing the Supervisory Analyst (Series 16) Examination.

Rule 344

RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/03

Supervisory Analysts (continued)Qualifications (continued)Experience

Appropriate experience for a candidate for Supervisory Analyst means having at least three years prior experience within the immediately preceding six years involving securities or financial analysis.

Examples of appropriate experience may include the following:

- Equity or Fixed Income Research Analyst;
- Credit Analyst for a securities rating agency;
- Supervising preparation of materials prepared by financial/securities analysts;
- Financial analytical experience gained at banks, insurance companies or other financial institutions;
- Academic experience relating to the financial/securities markets/industry.

Director of Research

A person having the title of "Director of Research" need not be a supervisory analyst as defined by the Rule so long as he/she does not approve research reports. If, however, such a person is in charge of registered representatives, he/she must qualify as a supervisory person under Rule 342.13.

/04

Exemptions

Successful completion of the CFA Level I Examination administered by the CFA Institute (in lieu of completion of Levels, I, II and III for a full CFA designation) will suffice to allow a Supervisory Analyst candidate to qualify by taking Part I of the Series 16 Qualification Examination.

(Next Page No. is 3450)

NYSE Rule 344/04

Rule 345A. Continuing Education For Registered Persons

(a) **Regulatory Element**—No member or member organization shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the continuing education requirements of Section (a) of this Rule.

- (1) Each registered person shall complete the Regulatory Element of the continuing education program on the occurrence of their second registration anniversary date and every three years thereafter or as otherwise prescribed by the Exchange. On each occasion, the Regulatory Element must be completed within one hundred twenty days after the person's registration anniversary date. A person's initial registration date, also known as the "base date", shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element of the program shall be determined by the Exchange for each registration category of persons subject to the rule.
- (2) **Failure to complete**—Unless otherwise determined by the Exchange, any registered persons who have not completed the Regulatory Element of the program within the prescribed time frames will have their registration deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this Rule shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. The Exchange may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.
- (3) **Disciplinary Actions**—Unless otherwise determined by the Exchange, a registered person will be required to re-take the Regulatory Element of the program and satisfy the program's requirements in their entirety in the event such person:

- (i) becomes subject to any statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 (see also Rule 346(f));
- (ii) becomes subject to suspension or to the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or
- (iii) is ordered pursuant to a disciplinary proceeding to re-take the Regulatory Element by any securities governmental agency or securities self-regulatory organization.

A re-taking of the Regulatory Element shall commence with participation within one hundred twenty days of the registered person becoming subject to the statutory disqualification, in the case of (i) above, or the completion of the sanction or the disciplinary action becoming final, in

the case of (ii) and (iii) above. The date that the disciplinary action becomes final will be deemed the person's new base date for purposes of this Rule.

(b) Firm Element

(1) Persons Subject to the Firm Element—The requirements of Section (b) of this Rule shall apply to any registered person who has direct contact with customers in the conduct of the member's or member organization's securities sales, trading or investment banking activities, and to the immediate supervisors of such persons, and to registered persons who function as supervisory analysts, and research analysts as defined in Rule 344 (collectively, "covered registered persons").

(2) Standards

(i) Each member and member organization must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skills and professionalism. At a minimum, each member and member organization shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the member's or member organization's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. If a member's or member organization's analysis determines a need for supervisory training for persons with supervisory responsibilities, such training must be included in the member's or member organizations's training plan.

(ii) **Minimum Standards for Training Programs**—Programs used to implement a member's or member organization's training plan must be appropriate for the business of the member or member organization and, at a minimum, must cover the following matters concerning securities products, services and strategies offered by the member or member organization:

- a. General investment features and associated risk factors;
- b. Suitability and sales practice considerations; and
- c. Applicable regulatory requirements.

(iii) **Administration of Continuing Education Program**—Each member and member organization must administer its continuing education program in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(3) Participation in the Firm Element—Covered registered persons included in a member's or member organization's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the member or member organization.

(4) **Specific Training Requirements**—The Exchange may require a member or member organization, either individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the Exchange deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

Amendments. March 3, 1998; July 29, 2003 (NYSE-2002-49); September 16, 2004 (SR-NYSE-2004-33)

• • • **Supplementary Material:** -----

.10 For purposes of this Rule, the term "registered person" means any member, allied member, registered representative, or other person registered or required to be registered under Exchange rules, but does not include any such person whose activities are limited solely to the transaction of business on the Floor with members or registered broker-dealers.

.20 For purposes of this Rule, the term "customer" means any natural person or any organization, other than a registered broker or dealer, executing transactions in securities or other similar instruments with or through, or receiving investment banking services from, a member or member organization.

.30 Any registered person who has terminated association with a registered broker or dealer and who has, within two years of the date of termination, become reassociated in a registered capacity with a registered broker or dealer shall participate in the Regulatory Element of the continuing education program at such intervals that apply (second registration anniversary and every three years thereafter) based on the initial registration anniversary date, rather than based on the date of reassociation in a registered capacity.

Any former registered person who becomes reassociated in a registered capacity with a registered broker or dealer more than two years after termination as such will be required to satisfy the program's requirements in their entirety (second registration anniversary and every three years thereafter), based on the most recent registration date.

Amendment. March 3, 1998.

.40 Any registration that is deemed inactive for a period of two calendar years pursuant to section (a)(2) of this Rule for failure of a registered person to complete the Regulatory Element, shall be terminated. A person whose registration is so terminated may become registered only by reapplying for registration and satisfying applicable registration and qualification requirements of Exchange rules (see Rule 345).

Adopted. January 30, 1995.

.50 Pursuant to Rule 345A(b)(1), all persons registered as research

analysts and supervisory analysts pursuant to Rule 344 must participate in a Firm Element Continuing Education program that includes training in applicable rules and regulations, ethics, and professional responsibility.

Adopted. July 29, 2003 (NYSE-2002-49).

NASD Manual

2711. Research Analysts and Research Reports

****NASD members must implement the provisions of Rule 2711 no later than Tuesday, July 9, 2002, except for those sections which indicate a different implementation date below ****

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1) "Investment banking department" means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(2) "Investment banking services" include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs or similar investments; or serving as placement agent for the issuer.

(3) "Member of a research analyst's household" means any individual whose principal residence is the same as the research analyst's principal residence.

(4) "Public appearance" means 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.

(5) "Research analyst" means the associated person who is primarily responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of "research analyst."

(6) "Research analyst account" means any account in which a research analyst or member of the research analyst's household has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. This term does not include a "blind trust" account that is controlled by a person other than the research analyst or member of the research analyst's household where neither the research analyst nor a member of the research analyst's household knows of the account's investments or investment transactions.

(7) "Research department" means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(8) "Research Report" means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

(9) "Subject company" means the company whose equity securities are the subject of a research report or a public appearance.

(b) Restrictions on Relationship with Research Department

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no personnel engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department or any other employee of the member who is not directly responsible for investment research ("non-research personnel"), other than legal or compliance personnel, may review or approve a research report of the member before its publication.

(3) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or identify any potential conflict of interest, provided that:

(A) any written communication between non-research personnel and research department personnel concerning the content of a research report must be made either through authorized legal or compliance personnel of the member or in a transmission copied to such personnel; and

(B) any oral communication between non-research personnel and research department personnel concerning the content of a research report must be documented and made either through authorized legal or compliance personnel acting as intermediary or in a conversation conducted in the presence of such personnel.

(c) Restrictions on Communications with the Subject Company

(1) Except as provided in paragraphs (c)(2) and (c)(3), a member may not submit a research report to the subject company before its publication.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in those sections, provided that:

(A) the sections of the research report submitted to the subject company do not contain the research summary, the research rating or the price target;

(B) a complete draft of the research report is provided to legal or compliance personnel before sections of the report are submitted to the subject company; and

(C) if after submitting the sections of the research report to the subject company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member must retain copies of any draft and the final version of such a research report for three years following its publication.

**** NASD members must implement the provisions of Rule 2711(c)(2) no later than Wednesday, September 9, 2002****

(3) The member may notify a subject company that the member intends to change its rating of the subject company's securities, provided that the notification occurs on the business day before the member announces the rating change, after the close of trading in the principal market of the subject company's securities.

(4) No research analyst may participate in efforts to solicit investment banking business. Accordingly, no research analyst may, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.

(5) A research analyst is prohibited from directly or indirectly:

(A) participating in a road show related to an investment banking services transaction; and

(B) engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

(6) Investment banking department personnel are prohibited from directly or indirectly:

(A) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and

(B) directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction.

(7) Any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

(d) Restrictions on Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) The compensation of a research analyst who is primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing such a research analyst's compensation, if applicable:

**** NASD members must implement the following provisions of Rule 2711(d)(2) no later than October 27, 2003****

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in reviewing and approving such a research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each such research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each such research analyst's compensation and documented the basis upon which this compensation was established.

(e) Prohibition of Promise of Favorable Research

No member may directly or indirectly offer favorable research, a specific rating or a specific price target, or threaten to change research, a rating or a price target, to a company as consideration or inducement for the receipt of business or compensation.

(f) Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage

(1) No member may publish or otherwise distribute a research report and no research analyst may make a public appearance regarding a subject company for which the member acted as manager or co-manager of:

(A) an initial public offering, for 40 calendar days following the date of the offering; or

(B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

(i) paragraphs (f)(1)(A) and (f)(1)(B) will not prevent a member from publishing or

otherwise distributing a research report, or prevent a research analyst from making a public appearance, concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that legal or compliance personnel authorize publication of that research report before it is issued or authorize the public appearance before it is made; and

(ii) paragraph (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), and will not prevent a research analyst from making a public appearance concerning such a company.

(2) No member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report or make a public appearance regarding that issuer for 25 calendar days after the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term "date of the offering" refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company with "actively traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), or to a public appearance concerning such a subject company.

(5) If a member intends to terminate its research coverage of a subject company, notice of this termination must be made. The member must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is impracticable for the member to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the member or if the member terminates coverage of the industry or sector). If it is impracticable to produce a final recommendation or rating, the final research report must disclose the member's rationale for the decision to terminate coverage.

(g) Restrictions on Personal Trading by Research Analysts

(1) No research analyst account may purchase or receive any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows.

(2) No research analyst account may purchase or sell any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending five calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company's securities; provided that:

(A) a member may permit a research analyst account to sell securities held by the account that are issued by a company that the research analyst follows, within 30 calendar days after the research analyst began following the company for the member;

(B) a member may permit a research analyst account to purchase or sell any security issued by a subject company within 30 calendar days before the publication of a research

report or change in the rating or price target of the subject company's securities due to significant news or a significant event concerning the subject company, provided that legal or compliance personnel pre-approve the research report and any change in the rating or price target.

(3) No research analyst account may purchase or sell any security or any option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.

(4) Legal or compliance personnel may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) legal or compliance personnel authorize the transaction before it is entered;

(B) each exception is granted in compliance with policies and procedures adopted by the member that are reasonably designed to ensure that these transactions do not create a conflict of interest between the professional responsibilities of the research analyst and the personal trading activities of a research analyst account; and

(C) the member maintains written records concerning each transaction and the justification for permitting the transaction for three years following the date on which the transaction is approved.

(5) The prohibitions in paragraphs (g)(1) through (g)(3) do not apply to a purchase or sale of the securities of:

(A) any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; or

(B) any other investment fund over which neither the research analyst nor a member of the research analyst's household has any investment discretion or control, provided that:

(i) the research analyst accounts collectively own interests representing no more than 1% of the assets of the fund;

(ii) the fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies that the research analyst follows; and

(iii) if the investment fund distributes securities in kind to the research analyst or household member before the issuer's initial public offering, the research analyst or household member must either divest those securities immediately or the research analyst must refrain from participating in the preparation of research reports concerning that issuer.

(6) Legal or compliance personnel of the member shall pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee. This pre-approval requirement shall apply to all persons, such as the director of research, supervisory analyst, or member of a committee, who have direct influence or control with respect to the preparation of the substance of research reports or establishing or changing a rating or price target of a subject company's equity securities.

(h) Disclosure Requirements

(1) Ownership and Material Conflicts of Interest

A member must disclose in research reports and a research analyst must disclose in public appearances:

(A) if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial

interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position);

(B) if, as of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

****NASD members must implement the provisions of Rule 2711(h)(1)(B) no later than Wednesday, November 6, 2002 ****

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

(2) Receipt of Compensation

**** NASD members must implement the new compensation and client disclosure provisions of Rule 2711(h)(2) no sooner than January 26, 2004 ****

(A) A member must disclose in research reports:

(i) if the research analyst received compensation:

a. based upon (among other factors) the member's investment banking revenues; or

b. from the subject company in the past 12 months.

(ii) the member or affiliate:

a. managed or co-managed a public offering of securities for the subject company in the past 12 months;

b. received compensation for investment banking services from the subject company in the past 12 months; or

c. expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(iii) if (1) as of the end of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) or (2) to the extent the research analyst or an employee of the member with the ability to influence the substance of the research knows:

a. the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months; or

b. the subject company currently is, or during the 12-month period preceding the date of distribution of the research report was, a client of the member. In such cases, the member also must disclose the types of services provided to the subject company. For purposes of this Rule 2711(h)(2), the types of services provided to the subject company shall be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(iv) if, to the extent the research analyst or an employee of the member with the ability to influence the substance of the research report knows an affiliate of the

member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

(v) if, to the extent the research analyst or member has reason to know, an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

a. This requirement will be deemed satisfied if such compensation is disclosed in research reports within 30 days after completion of the last calendar quarter, provided that the member has taken steps reasonably designed to identify any such compensation during that calendar quarter. This requirement shall not apply to any subject company as to which the member initiated coverage since the beginning of the current calendar quarter.

b. The research analyst and the member will be presumed not to have reason to know whether an affiliate received any compensation for products or services other than investment banking services from the subject company in the past 12 months if the member maintains and enforces policies and procedures reasonably designed to prevent the research analysts and employees of the member with the ability to influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.

(vi) For the purposes of this Rule 2711(h)(2), an employee of the member with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.

(B) A research analyst must disclose in public appearances:

(i) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the past 12 months;

(ii) if the research analyst received any compensation from the subject company in the past 12 months; or

(iii) if, to the extent the research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of distribution of the research report, was, a client of the member. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst.

(C) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(A)(ii)(b) and (c), (h)(2)(A)(iii)(b), or (h)(2)(B)(i) and (iii) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

**** NASD members must implement the provisions of Rule 2711(h)(2)(C) as they apply to disclosures under Rules 2711(h)(2)(A)(ii)(b) and (c) no later than July 29, 2003, and as they apply to disclosures under Rule 2711(h)(2)(A)(iii)(b), (h)(2)(B)(i) and (iii) by Jan. 26, 2004 ****

(3) Position as Officer or Director

A member must disclose in research reports and a research analyst must disclose in public appearances if the research analyst or a member of the research analyst's household serves as an officer, director or advisory board member of the subject company.

(4) Meaning of Ratings

A member must define in its research reports the meaning of each rating used by the member in its rating system. The definition of each rating must be consistent with its plain

meaning.

(5) Distribution of Ratings

(A) Regardless of the rating system that a member employs, a member must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy," "hold/neutral," or "sell" rating.

(B) In each research report, the member must disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months.

(C) The information that is disclosed under paragraphs (h)(5)(A) and (h)(5)(B) must 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).

****NASD members must implement the provisions of Rule 2711(h)(5) no later than Wednesday, September 9, 2002 ****

(6) Price Chart

A member must present in any research report concerning an equity security on which the member has assigned any rating for at least one year, a line graph of the security's daily closing prices for the period that the member has assigned any rating or for a three-year period, whichever is shorter. The line graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating and price target assigned or changed on those dates; and

(C) 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).

****NASD members must implement the provisions of Rule 2711(h)(6) no later than Wednesday, September 9, 2002 ****

(7) Price Targets

A member must disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by a disclosure concerning the risks that may impede achievement of the price target.

(8) Market Making

A member must disclose in research reports if it was making a market in the subject company's securities at the time that the research report was published.

(9) Disclosure Required by Other Provisions

In addition to the disclosure required by this rule, members and research analysts must provide disclosure in research reports and public appearances that is required by applicable law or regulation, including NASD Rule 2210 and the antifraud provisions of the federal securities laws.

(10) Prominence of Disclosure

The disclosures required by this paragraph (h) must be presented on the front page of research reports or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

(11) Disclosures in Research Reports Covering Six or More Companies

When a member distributes a research report covering six or more subject companies, for purposes of the disclosures required in paragraph (h), such research report may direct the reader in a clear manner as to where they may obtain applicable current disclosures in written or electronic format.

(12) Records of Public Appearances

Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (h) of this Rule. Such records must be maintained for three years from the date of the public appearance.

**** NASD members must implement the provisions of Rule 2711(h)(12) no later than Sept. 29, 2003****

(i) Supervisory Procedures

Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule (including the attestation requirements of Rule 2711(d)(2)), and a senior officer of such a member must attest annually to NASD by April 1 of each year that it has adopted and implemented those procedures.

****NASD members must implement the provisions of Rule 2711(i) in accordance with the implementation schedule for Rule 2711 ****

(j) Prohibition of Retaliation Against Research Analysts

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such an unfavorable public appearance.

**** NASD members must implement the provisions of Rule 2711(j) no later than July 29, 2003****

(k) Exceptions for Small Firms

**** NASD members must implement the provisions of Rule 2711(k) no later than July 29, 2003****

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

Amended by SR-NASD-2004-141 eff. June 6, 2005.
Amended by SR-NASD-2004-003 eff. April 26, 2004.
Amended by SR-NASD-2002-154 eff. July 29, 2003.
Amended by SR-NASD-2002-74 eff. June 4, 2002.
Adopted by SR-NASD-2002-21 eff. April 24, 2002.

Selected Notices to Members: 02-39, 03-44, 05-34.

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NASD Manual

1050. Registration of Research Analysts

(a) All persons associated with a member who are to function as research analysts shall be registered with NASD. Before registration as a Research Analyst can become effective, an applicant shall:

(1) be registered pursuant to Rule 1032 as a General Securities Representative; and

(2) pass a Qualification Examination for Research Analysts as specified by the Board of Governors.

(b) For the purposes of this Rule 1050, "research analyst" shall mean an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.

(c) Upon written request pursuant to the Rule 9600 Series, NASD will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has passed:

(1) Levels I and II of the Chartered Financial Analyst ("CFA") Examination; or

(2) if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e), Levels I and II of the Chartered Market Technician ("CMT") Examination; and

(3) has either functioned as a research analyst continuously since having passed the Level II CFA or CMT examination or applied for registration as a research analyst within two years of having passed the Level II CFA or CMT examination.

(d) An applicant who has been granted an exemption pursuant to paragraph (c) still must become registered as a General Securities Representative and then complete the regulatory portion of the Research Analyst Qualification Examination (Series 87) before that applicant can be registered as a Research Analyst.

(e) For the purposes of paragraph (c)(2), a "technical research report" shall mean a research report, as that term is defined in Rule 2711(a)(8), that is based solely on stock price movement and trading volume and not on the subject company's financial information, business prospects, contact with subject company's management, or the valuation of a subject company's securities.

(f) The requirements of paragraph (a) shall not apply to an associated person who is an employee of a non-member foreign affiliate who contributes to the preparation of a member's research report ("foreign research analyst"), provided the following conditions are met:

(1) the foreign research analyst resides and is employed in a jurisdiction that NASD has determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with this rule and the research analyst conflict of interest rules pursuant to Rule 2711;

(2) the foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdiction in which the foreign research analyst resides and is employed;

(3) the NASD member ("U.S. member") whose research reports a foreign research analyst contributes in the preparation of has imposed on its affiliates and the foreign research analysts they employ all of the provisions of Rule 2711 and all other research-related standards the member imposes on its own research reports and research analysts;

(4) the annual compliance attestation submitted by the U.S. member pursuant to Rule 2711(i) must encompass the global application of Rule 2711 to the U.S. member's foreign affiliates that participate in the preparation of the U.S. member's research reports;

(5) all U.S. member research reports to which a foreign research analyst contributes in the preparation must be approved by a properly registered principal or supervisory analyst pursuant to Rule 1022; and

(6) in addition to the disclosure requirements of Rule 2711, each U.S. member research report to which a foreign research analyst contributes in the preparation shall include the following on the front page:

(A) a statement that:

"This research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member or member organization. These research analysts are not registered/qualified as a research analyst with the NYSE and/or NASD, but instead have satisfied the registration/qualification requirements or other research-related standards of a foreign jurisdiction that have been recognized for these purposes by the NYSE and NASD."

(B) disclosures identifying each affiliate contributing to the research report, the location of such affiliate, and the names of the research analysts employed by the affiliate that contributed to the preparation of the research report;

(C) a general description of the relationship between the contributing affiliates and the U.S. member; and

(D) a reference to the page on which a separate "Foreign Affiliate Disclosures" section can be found. Such section shall disclose information on the nature of the affiliation between the entities, the affiliates' addresses, and the primary regulator in the jurisdiction(s) in which each affiliated entity is located.

(7) Members must establish and maintain records that identify those individuals who have availed themselves of the exemption in paragraph (f), specify the basis for such exemption, and evidence compliance with the conditions of paragraph (f).

Amended by SR-NASD-2005-043 eff. April 1, 2005.
Amended by SR-NASD-2005-022 eff. Feb. 4, 2005.
Amended by SR-NASD-2004-020 eff. March 30, 2004.
Amended by SR-NASD-2004-010 eff. Jan. 16, 2004.
Adopted by SR-NASD-2002-154 eff. July 29, 2003.

Selected Notice to Members: 03-44.

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NASD Manual

1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with NASD. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1) Requirements

No member shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person unless such person has complied with the requirements of paragraph (a) hereof.

Each registered person shall complete the Regulatory Element on the occurrence of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by NASD. On each occasion, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. A person's initial registration date, also known as the "base date," shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element shall be determined by NASD and shall be appropriate to either the registered representative or principal status of person subject to the Rule.

(2) Failure to Complete

Unless otherwise determined by the Association, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this Rule shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. A registration that is inactive for a period of two years will be administratively terminated. A person whose registration is so terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of the Rule 1020 Series and the Rule 1030 Series. The Association may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(3) Disciplinary Actions

Unless otherwise determined by NASD, a registered person will be required to retake the Regulatory Element and satisfy all of its requirements in the event such person:

(A) is subject to any statutory disqualification as defined in Section 3(a)(39) of the Act;

(B) is subject to suspension or to the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(C) is ordered as a sanction in a disciplinary action to retake the Regulatory Element by any securities governmental agency or self-regulatory organization.

The retaking of the Regulatory Element shall commence with participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (A) above, or the disciplinary action becoming final, in the case of (B) and (C) above. The date of the

disciplinary action shall be treated as such person's new base date with NASD.

(4) Reassociation in a Registered Capacity

Any registered person who has terminated association with a member and who has, within two years of the date of termination, become reassociated in a registered capacity with a member shall participate in the Regulatory Element at such intervals that may apply (second anniversary and every three years thereafter) based on the initial registration anniversary date rather than based on the date of reassociation in a registered capacity.

(5) Definition of Registered Person

For purposes of this Rule, the term "registered person" means any person registered with NASD as a representative, principal, assistant representative or research analyst pursuant to the Rule 1020, 1030, 1040, 1050 and 1110 Series.

(6) In-Firm Delivery of the Regulatory Element

Members will be permitted to administer the continuing education Regulatory Element program to their registered persons by instituting an in-firm program acceptable to the Association.

The following procedures are required:

(A) Principal/Officer In-Charge. The firm has designated a principal to be responsible for the in-firm delivery of the Regulatory Element.

(B) Site Requirements.

(i) The location of all delivery sites will be under the control of the firm.

(ii) Delivery of Regulatory Element continuing education will take place in an environment conducive to training. (Examples: a training facility, conference room or other area dedicated to this purpose would be appropriate. Inappropriate locations would include a personal office or any location that is not or cannot be secured from traffic and interruptions.)

(iii) Where multiple delivery terminals are placed in a room, adequate separation between terminals will be maintained.

(C) Technology Requirements. The communication links and firm delivery computer hardware must comply with standards defined by the Association or its designated vendor.

(D) Supervision.

(i) The firm's Written Supervisory Procedures must contain the procedures implemented to comply with the requirements of in-firm delivery of the Regulatory Element continuing education.

(ii) The firm's Written Supervisory Procedures must identify the principal designated pursuant to Rule 1120(a)(6)(A) and contain a list of individuals authorized by the firm to serve as proctors.

(iii) Firm locations for delivery of the Regulatory Element continuing education will be specifically listed in the firm's Written Supervisory Procedures.

(E) Proctors.

(i) All sessions will be proctored by an authorized person during the entire Regulatory Element session. Proctors must be present in the session room or must be able to view the person(s) sitting for Regulatory Element continuing education through a window or by video monitor.

(ii) The individual responsible for proctoring at each administration will sign a certification that required procedures have been followed, that no material from

Regulatory Element continuing education has been reproduced, and that no candidate received any assistance to complete the session. Such certification may be part of the sign-in log required under Rule 1120(a)(6)(F).

(iii) Individuals serving as proctors must be persons registered with an SRO and supervised by the designated principal for purposes of in-firm delivery of the Regulatory Element continuing education.

(iv) Proctors will check and verify the identification of all individuals taking Regulatory Element continuing education.

(F) Administration.

(i) All appointments will be scheduled in advance using the procedures and software specified by the Association to communicate with the Association's system and designated vendor.

(ii) The firm/proctor will conduct each session in accordance with the administrative appointment scheduling procedures established by the Association or its designated vendor.

(iii) A sign-in log will be maintained at the delivery facility. Logs will contain the date of each session, the name and social security number of the individual taking the session, that required identification was checked, the sign-in time, the sign-out time, and the name of the individual proctoring the session. Such logs are required to be retained pursuant to SEC Rules 17a-3 and 17a-4.

(iv) No material will be permitted to be utilized for the session nor may any session-related material be removed.

(v) Delivery sites will be made available for inspection by the SROs.

(vi) Before commencing in-firm delivery of the Regulatory Element continuing education, members are required to file with their Designated Examining Authority ("DEA"), a letter of attestation (as specified below) signed by a principal executive officer or executive representative, attesting to the establishment of required procedures addressing principal in-charge, supervision, site, technology, proctors, and administrative requirements. Letters filed with NASD Regulation, Inc. should be sent to Member Regulation, Continuing Education Department, 9509 Key West Avenue, Rockville, MD 20850.

Letter of Attestation for In-Firm Delivery of Regulatory Element Continuing Education

[Name of member] has established procedures for delivering Regulatory Element continuing education on its premises. I have determined that these procedures are reasonably designed to comply with SRO requirements pertaining to in-firm delivery of Regulatory Element continuing education, including that such procedures have been implemented to comply with principal/officer in-charge, supervision, site, technology, proctors, and administrative requirements.

Signature

Printed name

Title [Must be signed by a Principal Executive Officer (or Executive Representative) of the firm]

Date

(7) Regulatory Element Contact Person

Each member shall designate and identify to NASD (by name and e-mail address) an individual or individuals responsible for receiving e-mail notifications provided via the Central Registration Depository regarding when a registered person is approaching the end of his or her Regulatory Element time frame and when a registered person is deemed inactive due to failure to complete the requirements of the Regulatory Element program, and provide prompt notification to NASD regarding any change in such designation(s). Each member must review and, if necessary, update the information regarding its Regulatory Element contact person(s) within 17 business days after the end of each calendar quarter to ensure the information's accuracy.

(b) Firm Element

(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to Rule 1050, and to the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

(2) Standards for the Firm Element

(A) Each member must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each member shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the member's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. If a member's analysis establishes the need for supervisory training for persons with supervisory responsibilities, such training must be included in the member's training plan.

(B) Minimum Standards for Training Programs — Programs used to implement a member's training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

- (i) General investment features and associated risk factors;
- (ii) Suitability and sales practice considerations;
- (iii) Applicable regulatory requirements; and
- (iv) With respect to registered research analysts and their immediate supervisors, training in ethics, professional responsibility and the requirements of Rule 2711.

NASD members must implement the provisions of Rule 1120(b)(2)(B)(iv) on January 26, 2004, or such later date as determined by NASD

(C) Administration of Continuing Education Program — A member must administer its continuing education programs in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(3) Participation in the Firm Element

Covered registered persons included in a member's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the member.

(4) Specific Training Requirements

The Association may require a member, individually or as part of a larger group, to provide specific training to its covered registered persons in such areas as the Association deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

Amended by SR-NASD-2004-098 eff. April 4, 2005.
Amended by SR-NASD-2003-183 eff. April 16, 2004.
Amended by SR-NASD-2002-154 eff. July 29, 2003.
Amended by SR-NASD-2000-64 eff. March 11, 2001.
Amended by SR-NASD-98-03 eff. July 1, 1998.
Amended by SR-NASD-95-22 eff. July 1, 1995.
Adopted by SR-NASD-94-72 eff. July 1, 1995.

Selected Notices to Members: 94-59, 95-13, 95-35, 96-27, 98-23, 01-14, 03-44, 04-22, 05-20.

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Notice to Members

JULY 2002

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Advertising
Investment Banking
Research Reports

Research Analysts and Research Reports

SEC Approves Rule Governing Research Analysts' Conflicts of Interest

Executive Summary

On May 10, 2002, the SEC approved new NASD Rule 2711, Research Analysts and Research Reports. The rule is intended to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions. The SEC also approved on that day similar proposed amendments to New York Stock Exchange (NYSE) Rule 472. The rules will be implemented in phases during the period from July 9, 2002, to November 6, 2002.

This *Notice* includes as Attachment A the text of the new rule and the implementation schedule of the rule's effective dates. This *Notice* also includes as Attachment B a Joint Memorandum of NASD and the NYSE that provides interpretive guidance for the NASD and NYSE rules governing research reports and analysts.

Research Reports Must Reflect an Analyst's Actual Opinion

Rule 2711 is intended to restore investor confidence in a process that is critical to the equities markets. The rule reflects a self-policing approach consistent with strong self-regulation. Members and research analysts must take all measures that are necessary to ensure that all research reports reflect an analyst's honest views and that any opinion or recommendation is not influenced by conflicts of interest. If a member issues a report or a research analyst renders an opinion that is inconsistent with the analyst's actual views regarding a subject company, NASD considers such action to constitute a fraudulent act and conduct inconsistent with just and equitable principles of trade.

02-39

Disclosure Required by NASD Rule 2210

The Joint Memorandum discusses interpretive issues that are common to NASD Rule 2711 and NYSE Rule 472 with regard to research reports and research analysts. Members should refer to the Joint Memorandum for a discussion of most of these interpretive issues.

One issue is unique to NASD members, however, and thus covered in this *Notice*. In addition to the disclosures required by Rule 2711, NASD members and research analysts must provide disclosure in research reports that is required by NASD Rule 2210. In two cases, Rule 2711's disclosure requirements operate differently than those under Rule 2210.

First, Rule 2210(d)(2)(B)(i)(a) requires disclosure if the member *"usually makes a market* in the securities being recommended," while Rule 2711(h)(8) requires disclosure if the member *"was making a market in the subject company's securities at the time that the research report was published."* Second, Rule 2210(d)(2)(B)(i)(c) requires disclosure if the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years, while Rule 2711(h)(2)(A)(ii)(a) only requires disclosure of this information for the past 12 months.

In these two situations, a member's compliance with the requirements of Rule 2711(h) will override the disclosure requirements of Rule 2210(d)(2)(B)(i). Members still must comply with all other disclosure requirements of Rule 2210, such as those regarding buying or selling securities on a principal basis and ownership of options, rights, or warrants. Additionally, member communications other than research reports remain subject to all applicable provisions of Rule 2210, including those regarding recommendations.

Questions/Further Information

Questions or comments concerning NASD Rule 2711 or this *Notice* may be directed to the NASD Corporate Financing Department at (240) 386-4623.

New York Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

Information Memo

Member Firm Regulation



Number 02-26
June 26, 2002

ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS,
RESEARCH, COMPLIANCE, LEGAL, AND INVESTMENT
BANKING DEPARTMENTS

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: DISCLOSURE AND REPORTING REQUIREMENTS

On May 10, 2002, the Securities and Exchange Commission approved amendments to Exchange Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements")¹ (see attached Exhibit B). The SEC also simultaneously approved new NASD Rule 2711 ("Research Analysts and Research Reports").

The amendments 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. The amendments are intended to increase associated persons' (research analysts) independence from influences within their firms and provide disclosure of conflicts of interests which might potentially bias such associated persons and the research reports they produce.

This Information Memo includes a Joint Memorandum of NYSE and NASD (see attached Exhibit A) that provides interpretive guidance for the new NYSE and NASD Rules as well as the implementation schedule for the Rules (please see NYSE Information Memo No. 02-24, dated May 20, 2002, for additional information).

Questions regarding this Memo may be directed to William Jannace at (212) 656-2744 or Mary Anne Furlong at (212) 656-4823.

Salvatore Pallante
Executive Vice President

Attachments

¹ SR-NYSE-2002-09, Securities Exchange Act Release No. 45908 (May 10, 2000).



**JOINT MEMORANDUM
OF
NASD AND THE NEW YORK STOCK EXCHANGE**

**Discussion and Interpretation of Rules Governing Research Analysts and Research Reports
(NASD Rule 2711 and NYSE Rules 351 and 472)**

Background

On May 10, 2002, the Securities and Exchange Commission ("SEC") approved new NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to New York Stock Exchange ("NYSE") Rules 351 ("Reporting Requirements") and 472 ("Communications with the Public") with respect to research analysts and research reports (collectively, NASD Rule 2711 and the amendments to NYSE Rules 351 and 472 are referred to as the "SRO Rules").

The SRO Rules implement reforms designed to increase analyst independence and to provide more extensive disclosure of conflicts of interest in research reports and public appearances. Generally, the SRO Rules restrict the relationship between research and investment banking departments; require disclosure of financial interests in covered companies by the analyst and the firm; require disclosure of existing and potential investment banking relationships with subject companies; impose quiet periods for the issuance of research reports; restrict personal trading by analysts; and require disclosure of information that helps investors track the correlation between an analyst's rating and the stock's price movements.

The SRO Rules are being phased in to give members time to adopt compliant systems and procedures. Most provisions of the Rules will go into effect on July 9, 2002, with the following exceptions. The provisions requiring disclosure of firm ownership of 1% or more of any class of common equity securities of the subject company¹ and related written procedures² become effective November 6, 2002. The following rules and their accompanying written procedures become effective on September 9, 2002: the gatekeeper functions;³ the required disclosure of ratings distribution;⁴ and the price charts.⁵ The NYSE had previously issued an information

¹ NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

² NASD Rule 2711(i) and NYSE Rule 472(c).

³ NASD Rule 2711(b)(2) and (3), NASD Rule 2711(c)(1) and (2) and NYSE Rule 472(b)(2) and (3).

⁴ NASD Rule 2711(h)(5) and NYSE Rule 472(k)(2)(iv).

⁵ NASD Rule 2711(h)(6) and NYSE Rule 472(k)(2)(v).

memo outlining the implementation schedule (see NYSE Information Memo No. 02-24, dated May 20, 2002).

In its approval order, the SEC noted that NASD and the NYSE (collectively, the “SROs”) would provide interpretive guidance on certain provisions of the SRO Rules. This Joint Memorandum provides that guidance, and addresses certain other issues that NASD and NYSE members have raised since the SEC approved the SRO Rules. This Joint Memorandum does not attempt to address every possible interpretive question or factual scenario that might arise under the Rules. As with other SRO Rules, the NASD and NYSE staffs will consider additional requests for interpretive guidance on a case-by-case basis.

For purposes of the NYSE Rules, the term “research analyst” as used in the Joint Memorandum refers to any “associated person” as that term is defined in NYSE Rule 472.40. In addition, for purposes of the NYSE Rules, the term “member” refers to both members and member organizations of the NYSE.

Definitions

The SRO Rules include a number of definitions that are important to their application. Certain of these definitions are discussed in more detail below.

Investment Banking Services

The SRO Rules⁶ define “investment banking services” to include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transactions) or similar investments; or serving as placement agent for the issuer. The term also includes acting as a member of a selling group in a securities underwriting.

Household Members

NASD Rule 2711(a)(3) defines the term “member of a research analyst’s household,” and NYSE Rule 472.40 defines the term “household member,” to mean any individual whose principal residence is the same as the research analyst’s principal residence. These terms do *not* include, however, a roommate, apartment mate or other *unrelated* person who shares the same residence as a research analyst if that person is not financially dependent on the research analyst, or the research analyst is not financially dependent on that person.

Public Appearance

“Public appearance” is defined in the SRO Rules⁷ to mean any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security. This term includes a research analyst’s participation in a conference call or web cast that is open to the public in which the analyst makes a recommendation or offers an opinion concerning an equity security.

⁶ NASD Rule 2711(a)(2) and NYSE Rule 472.20

⁷ NASD Rule 2711(a)(4) and NYSE Rule 472.50

Research Analyst and Associated Person

NASD Rule 2711(a)(5) defines "research analyst" to mean "the associated person who is principally responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of 'research analyst.'" NYSE Rule 472.40 defines "associated person" for purposes of its rule to include "a member, allied member, or employee of a member or member organization responsible for, and any person who reports directly or indirectly to such associated person in connection with the making of the recommendation to purchase, sell or hold an equity security in research reports, or public appearances or establish a rating or price target of a subject company's equity securities."

These terms do not include every registered person who may express an opinion on an equity security. Thus, for example, the terms exclude registered representatives who recommend securities to their customers, so long as they do not prepare the substance of research reports and do not report to persons who do prepare research reports. The terms also exclude investment advisers, such as mutual fund portfolio managers, who are not principally responsible for preparing the substance of a research report, even if they are registered persons of members.

Research Analyst Account

NASD Rule 2711(a)(6) defines "research analyst account" to mean any account in which a research analyst or member of the research analyst's household has a financial interest or over which the analyst has discretion or control. NYSE Rule 472 does not include a comparably defined term. However, NYSE Rule 472.40 generally applies the rule's personal trading restrictions and disclosure requirements to any account over which an associated person has a financial interest, or over which the associated person exercises discretion or control. Under both NASD Rule 2711(a)(6) and NYSE Rule 472.40, if a research analyst manages the portfolio investments of a registered investment company, the investment company is not a "research analyst account" for purposes of NASD Rule 2711, and is not subject to the personal trading restrictions or disclosure requirements of NYSE Rule 472.

Research Report

Under the SRO Rules,⁸ the term “research report” has four components. A “research report” is (1) a written or electronic communication, (2) that includes an analysis of equity securities of individual companies or industries, (3) that provides information reasonably sufficient upon which to base an investment decision, and (4) that includes a recommendation. Members should consider each communication in this context in determining whether it is or is not a “research report.” The term “research report” includes any public communication of a member that falls within the definition, regardless of the means of distribution or whether the report of the member is distributed within or outside the United States.

Member communications that mention or discuss particular equity securities come in a variety of forms, and it is not possible to provide a complete list of all types of communications that fall or do not fall within this definition. The issue of whether a particular communication constitutes a “research report” for purposes of the SRO Rules will turn on the individual facts and circumstances surrounding that communication. The SROs generally would *not* consider the following communications to be “research reports”:

- Reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index, that do not recommend or rate individual securities.
- Reports commenting on economic, political or market conditions that do not recommend or rate individual securities.
- Technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price.
- Statistical summaries of multiple companies’ financial data (including listings of current ratings) that do not include any narrative discussion or analysis of individual companies’ data.
- Reports that recommend increasing or decreasing holdings in particular industries or sectors but that do not contain recommendations or ratings for individual securities.
- Notices of ratings or price target changes that do not contain any narrative discussion or analysis of the company, provided that the member simultaneously directs the readers of the notice as to where they may obtain the most recent research report on the subject company that includes the disclosures required by the SRO Rules. In no event should such a notice refer to a research report that contains materially misleading disclosure, i.e., where disclosures are no longer applicable or new disclosures would pertain.
- An analysis prepared by a registered representative for a specific customer’s account.
- Internal communications that are not given to customers.

For purposes of this definition, the term “equity security” has the same meaning as defined in Section 3(a)(11) of the Securities Exchange Act of 1934 (the “Exchange Act”).⁹

⁸ NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).

⁹ See 15 U.S.C. 78c(a)(11).

Application of the SRO Rules to Third Party Research

The SROs have received a number of questions regarding whether the SRO Rules apply to research distributed by a member that is produced by a third party. In general, the SRO Rules are intended to address conflicts of interest that can arise when a member produces its own research. When a member distributes research produced by an independent third party generated in accordance with a soft-dollar arrangement, the member's disclosure requirements do not apply. If the independent third-party source of the research is also an NASD or NYSE member, the third-party member firm must comply with the applicable SRO Rules' provisions described below.

In some cases, a member may distribute research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party other than through a soft-dollar arrangement. The member must however, accompany this research with the following disclosures, to the extent applicable:

- the member's and its affiliates' ownership of the subject company's securities;¹⁰
- that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;¹¹
- that the member was making a market in the subject company's securities at the time the research report was published;¹² and
- any other actual, material conflict of interest of the member known at the time of distribution of the research report.¹³

Generally, a member will not be considered to have distributed independent third-party research to a customer when the customer independently requests or accesses such research from the member or the member makes such research available to its customers through the member's or a third party's web site and customers select their own research.

Prohibition of Certain Forms of Analyst Compensation

The SRO Rules¹⁴ expressly prohibit the payment of a "bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services

¹⁰ NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

¹¹ Rules NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(ii).

¹² NASD Rule 2711(h)(8) and NYSE Rule 472(k)(2)(i).

¹³ NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(i)c. as they pertain solely to the member.

¹⁴ NASD Rule 2711(d) and NYSE Rule 472(h).

transaction.” The SROs have received questions as to the continuing validity of existing contractual arrangements that contain compensation agreements contrary to these SRO Rule provisions.

The SROs are of the view that as of the effective date for that provision of the SRO Rules (July 9, 2002), any contractual provision that provides for compensation based upon specific banking transactions that have not yet closed is inconsistent with the SRO Rules. A member may not pay compensation based on specific investment banking transactions that may have been entered into before the effective date but that will not close until after the effective date. However, research analysts may be compensated, pursuant to contractual agreements executed prior to July 9, 2002, for any investment banking transactions that have closed before that date.

Prohibition of Promises of Favorable Research

The SRO Rules¹⁵ prohibit members from directly or indirectly offering a company favorable research, a specific rating or a specific price target, or threatening to change research, a rating or price target, as consideration or inducement for the receipt of business or compensation. These provisions extend to the research, ratings and price targets issued by an affiliate, since the rule prohibits indirect as well as direct actions.

Nevertheless, these provisions are not intended to prevent a member’s investment banking department from obtaining a research analyst’s view of a prospective client before committing to undertake an investment banking transaction. They also do not prevent a member from agreeing to provide research as part of its investment banking agreement with a subject company, so long as there is no promise of *favorable* research.

Quiet Periods

The SRO Rules¹⁶ generally prohibit a member from publishing a research report on a company for which the member has acted as manager or co-manager for 40 calendar days after an initial public offering and 10 calendar days after a secondary offering. The SRO Rules provide an exception for publication of research concerning the effects of significant news or a significant event relating to the subject company during those quiet periods. For purposes of these Rules “significant news or a significant event” refers to any news or event that is expected to have a material impact on, or that is expected to cause a material change to, the subject company’s operations, earnings or financial condition. The SRO Rules also exempt research reports issued pursuant to SEC Rule 139 for certain secondary offerings of “actively-traded” securities as defined in Rule 101(c)(1) of Regulation M of the Exchange Act.

The SRO Rules impose the 40-day or 10-day quiet periods, as applicable, following the date of the offering. Members have requested clarification of the definition of date of the offering. For NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) (regarding IPOs), members should use the effective date of the registration statement as the date of the offering. For some secondary offerings, particularly shelf-offerings, the effective date of registration may not be meaningful for the purposes of the Rules. Accordingly, for NASD Rule 2711(f)(2) and NYSE Rule 472(f)(2), the date of offering is the date on which the secondary shares are first offered to the public.

¹⁵ NASD Rule 2711(e) and NYSE Rule 472(g).

¹⁶ NASD Rule 2711(f) and NYSE Rule 472(f)(1) and (2).

As noted above, the SRO Rules apply only to “equity security” offerings, as that term is defined in Section 3(a)(11) of the Exchange Act. This definition includes convertible debt offerings. The provisions do not apply with respect to straight debt offerings.

The quiet period requirements only apply to IPOs and secondary offerings that occur on or after July 9, 2002. Offerings that occur before July 9, 2002 are not subject to these provisions.

Personal Trading

The SRO Rules¹⁷ impose a number of restrictions on the personal trading of securities in accounts in which a research analyst or a member of his or her household has a financial interest or over which the analyst has discretion or control. For purposes of both SROs’ rules, these accounts are referred to herein as “research analyst accounts.”

Prohibition of Purchasing or Receiving Pre-IPO Securities

The SRO Rules¹⁸ prohibit a research analyst account from purchasing or receiving any securities before the issuer’s initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows. This prohibition applies to shares of any private company that engages in the same types of business that the analyst follows, regardless of whether the company ever goes public.

The SRO Rules do not require a research analyst to divest pre-IPO shares of a company that the research analyst already owned before the SRO Rules’ effective date. However, research analysts in these situations may not provide research on the company unless the analyst has divested all pre-IPO shares in the company.

The SROs have received questions on the meaning of the term “same types of business as companies that the research analyst covers.” As a general matter, a member should assume that an issuer falls within this category if the issuer would be assigned to the analyst if the member began covering the issuer. To the extent that there are still questions, an acceptable approach would be to include all companies that are classified as being in the same industry as the companies that the analyst covers by a nationally recognized system of industry classification.

Blackout Periods

The SRO Rules¹⁹ generally prohibit a research analyst account from purchasing or selling any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company’s securities. For purposes of this provision, the publication date of a research report is the date that a member first disseminates the report.

¹⁷ NASD Rule 2711(g) and NYSE Rule 472(e).

¹⁸ NASD Rule 2711(g)(1) and NYSE Rule 472(e)(1).

¹⁹ NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).

Under the SRO Rules²⁰, a member may permit a research analyst to issue a research report or change a rating or price target for a subject company fewer than 30 days after a research analyst account has traded the subject company's securities if the report or change is due to significant news or a significant event concerning the subject company. The member's legal or compliance department must pre-approve the research report or any change in the subject company's rating or price target.

Exceptions for Investment Funds

The SRO Rules²¹ exclude investments in certain investment funds from the personal trading restrictions in NASD Rule 2711(g)(1) through (g)(3) and NYSE Rule 472(e)(1) through (e)(3). The SRO Rules²² provide that the personal trading restrictions do not apply to investments in registered diversified investment companies as defined in Section 5(b)(1) of the Investment Company Act of 1940.²³ If a research analyst invests in a registered investment company that is not diversified, the investment company must meet the requirements of NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v) in order to be excluded from the personal trading restrictions.

The SRO Rules²⁴ also exclude any other investment fund over which neither the research analyst nor household member has any investment discretion or control from the personal trading restrictions, provided that the fund meets three criteria. First, the research analyst account(s) collectively owns interests representing no more than 1% of the assets of the fund. Second, the fund invests no more than 20% of its assets in the same types of business as companies that the research analyst follows.²⁵ Third, if the investment fund distributes securities in kind to the research analyst or household member before the issuer's IPO, the research analyst or household member must either divest those securities immediately or the research analyst must refrain from participating in the preparation of research reports concerning that issuer.

Members have inquired whether holdings of investment funds that were purchased or received prior to July 9, 2002 are excluded from the trading restrictions in the SRO Rules.²⁶ In general, the SROs will not apply the trading restrictions to these investments. However, if a research analyst or household member makes or receives additional investments in those funds after July 9, 2002, all fund holdings would be subject to the trading restrictions to the extent those funds do not meet the requirements of the SRO Rules.²⁷

²⁰ NASD Rule 2711(g)(2)(B) and NYSE Rule 472(e)(4)(ii).

²¹ NASD Rule 2711(g)(5) and NYSE Rules 472(e)(4)(v) and (vi).

²² NASD Rule 2711(g)(5)(A) and NYSE Rule 472(e)(4)(vi).

²³ 15 U.S.C. 80a-5(b)(1).

²⁴ NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

²⁵ The phrase "same types of business as companies that the research analyst follows" has the same meaning as under the restrictions on purchasing and receiving pre-IPO securities. See discussion of NASD Rule 2711(g)(1) and NYSE Rule 472(e)(1).

²⁶ NASD Rule 2711(g)(1), (2) and (3) and NYSE Rule 472(e)(1), (2) and (3).

²⁷ NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

Members also have inquired as to when the 1% and 20% tests must be measured. In order to qualify for the trading exceptions of the SRO Rules²⁸ an investment fund must meet the 1% and 20% tests each time a research analyst makes or receives additional investments in the fund.

Disclosure Requirements

The SRO Rules impose a number of disclosure requirements on members and research analysts with respect both to research reports and public appearances. Members are reminded that there may be additional disclosures required by SEC Rule 10b-5 or other securities laws and rules. Certain of the SRO Rules' disclosure requirements are discussed below.

Member Ownership of Subject Company Securities

The SRO Rules²⁹ require a member or research analyst to disclose in a research report and a public appearance if, as of the end of the month preceding publication of a research report or a public appearance, the "member or its affiliates" beneficially owned 1% or more of any class of common equity securities of the subject company. Several members have requested guidance as to the scope of "affiliate" ownership in this provision, including whether it encompasses mutual funds managed by an affiliated investment adviser, ownership by member employees, and trust accounts managed by an affiliated bank. Members have further inquired whether they may, or must, aggregate their affiliate positions for the purposes of the disclosure requirement.

The SRO Rules refer to Section 13(d) of the Exchange Act for the standards to determine what constitutes beneficial ownership. Thus, members must include the holdings of an affiliate or accounts managed by an affiliate to the same extent those holdings are subject to the Section 13(d) reporting requirements. Members should look to the SEC rules promulgated pursuant to Section 13(d) and relevant interpretations by the SEC to determine which affiliate holdings must be included in calculating whether firm ownership meets the 1% disclosure threshold. While firms must aggregate those affiliate positions that fall under the Section 13(d) reporting requirements, firms may additionally show those positions disaggregated from the member's own holdings.

The SRO Rules³⁰ further require disclosure of "any other actual, material conflict of interest" of which the analyst "knows or has reason to know" at the time of the research report or public appearance. Some members have asked whether this requirement creates a duty of inquiry by the analyst to learn of confidential, non-public information. The "knows or has reason to know" language is intended to require disclosure of those material conflicts of interest of which the analyst has actual knowledge, as well as those conflicts that should be reasonably discovered in the ordinary course of business. The provision does not impose a duty on an analyst to inquire concerning confidential, non-public material information that is properly segregated by a firm's informational barriers.

²⁸ NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

²⁹ NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

³⁰ NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(i)c.

Member Receipt of Compensation from Subject Company

The SRO Rules³¹ require a member to disclose in research reports if the member or its affiliates: (a) managed or co-managed a public offering of the subject company's securities in the past 12 months; (b) received compensation for investment banking services from the subject company in the past 12 months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months. The Rules do not define the term "affiliate" for purposes of this provision.

The SROs deem that the term "affiliate" includes any company that controls, is controlled by, or is under common control with, the member. "Affiliate" does not include individuals employed by the member or an affiliate. "Control" means the power to direct, or cause the direction of, the management or policies of a company, whether through ownership of securities, by contract or otherwise.³²

Meaning of Ratings

The SRO Rules³³ require a member to define in its research reports the meaning of each rating used by the member in its ratings system. For example, a member might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next 12-month period.³⁴ The definition of each rating must be consistent with its plain meaning. Thus, for example, a "hold" rating should not mean or imply that an investor should sell a security.

In some cases, a member may employ multiple ratings systems based upon the investor's time horizon. For example, the member may present ratings for "long," "intermediate" and "short" term investors. In such cases, the member is required to disclose the meanings of the ratings used in each of the ratings systems.

Distribution of Ratings

The SRO Rules³⁵ require a member to disclose in each research report the percentage of all securities rated by the member to which the member has assigned a "buy," "hold/neutral" or "sell" rating. For example, a research report might disclose that the member has assigned a "buy" rating to 58% of the securities that it follows, a "hold/neutral" rating to 15%, and a "sell" rating to 27%. The SRO Rules³⁶ require this information to be current as of the end of the most recent calendar quarter. If the publication date of the research report is fewer than 15 calendar days after the end of the most recent calendar quarter, the information must be current as of the second most recent calendar quarter end. If a firm does not employ a rating system that uses the terms

³¹ NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(ii).

³² See also NASD Rule 2720(b)(1) and NYSE Rule 2.

³³ NASD Rule 2711(h)(4) and NYSE Rule 472(k)(2)(iii).

³⁴ When a rating is defined in terms of a security's performance relative to the market or sector, there is no requirement also to disclose a member's market or sector forecast.

³⁵ NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(2)(iv).

³⁶ NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.

“buy,” “hold/neutral” and “sell,” a member must determine, based on its own ratings system, into which of the three categories its ratings fall.

When a member employs multiple ratings systems based on the investor’s time horizon, the member is required to disclose the distributions of the ratings used in each of the ratings systems. As discussed above, the distribution need only reflect ratings of equity securities as defined by Section 3(a)(11) of the Exchange Act.

The SRO Rules³⁷ require a member to disclose in each research report the percentage of subject companies within each of the three categories (buy, hold/neutral, sell) for whom the member has provided investment banking services within the last 12 months. For example, if 20 of the 25 companies to which the member has assigned a “buy” rating are investment banking clients of the member, the member would have to disclose that 80% of the companies that received a “buy” rating are its investment banking clients.

Price Chart

The SRO Rules³⁸ require members to include with any research report in which the member has assigned a rating for at least one year a graph that indicates the correlation between the price movement of the subject security and the ratings and price targets assigned by the member. The line graph must cover the period for which a member has assigned a rating or three years, whichever is shorter. This requirement has raised several questions.

First, members have inquired whether a table may be substituted for the chart when the research report is delivered through a technology that will not allow transmission of graphic illustrations. A member may use a table in such circumstances, provided that the table provides all the required data and is presented in an easily readable format. If a table is used rather than a chart, the table is only required to provide the stock closing prices for the days on which the member assigned or changed a rating or price target. However, members may not opt to use a table format if technology is reasonably available to transmit the information as a chart.

Second, members have asked for guidance to comply with the price chart provision when the member employs multiple ratings systems depending on the investor’s time horizon (e.g., short, intermediate and long-term). In such cases, the price chart must show the ratings and price targets assigned to the subject company’s stock for each ratings system.

Third, members have asked whether the SRO Rules permit inclusion of a benchmark performance, such as the S&P 500 Index, in the price chart. Members may include such benchmarks at their discretion, so long as the information required by the rule is prominent and clearly depicted on the chart. If a member uses a benchmark in a research report’s price chart, the member should use the same benchmark in the price charts for all research reports of subject companies within the same industry or peer group.

Fourth, members have inquired whether they must include information about ratings and price targets assigned before the SRO Rules become effective. Members must include that information on price charts for any security that has been assigned a rating for at least a year before a research report is issued. Members have also asked whether the SROs might exempt firms that do not

³⁷ NASD Rule 2711(h)(5)(B) and NYSE Rules 472(k)(2)(iv) and 472.70.

³⁸ NASD Rule 2711(h)(6) and NYSE Rule 472(k)(2)(v).

have the historical information readily available in electronic databases that go back as many as three years from the effective date. The price chart provision does not take effect until September 9, 2002. This date provides adequate time to compile the necessary information, particularly given the fact that existing NASD Rule 2210(b)(2) and NYSE Rule 472(d) (formerly Rule 472(c)) already require firms to maintain a file of all sales literature, including research reports, for three years.

Fifth, members have sought guidance on their obligations when coverage of a security is transferred from one analyst to another, i.e., whether the chart should reflect only the recommendations and price targets of the analyst to whom the security is currently assigned, or whether it should reflect data from all analysts during the period covered by the chart. The price chart is intended to depict the recommendations of the member, not the individual analyst. Consequently, the price chart must reflect all ratings and price targets during the specified period, irrespective of the analyst. The SROs would not object, however, if members chose to include additional information on the price chart that indicates when coverage shifted to a new analyst.

Sixth, some members have asked how “breaks” in coverage affect the obligation to include historical data for securities that have been assigned a rating for at least one year. Breaks in coverage would not restart the clock to determine the one-year coverage period. Moreover, the SROs expect members to indicate the breaks in coverage on the price charts.

Price Targets

The SRO Rules³⁹ require a member to disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by disclosure concerning the risks that may impede achievement of a price target. This provision however does not require a member to include a price target in a research report.

Prominence of Disclosure

The disclosures required by the SRO Rules must appear on the front page of the research report or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

Electronic research reports may utilize hyperlinks to this disclosure, provided that the first screen that the investor sees clearly and prominently labels the hyperlinks to the required disclosures. When hyperlinks are not possible (such as a report in PDF format), members should follow the requirements for paper reports. Thus, for example, the first printed page of a PDF document must either have the disclosures or refer the reader to the pages where the disclosures appear.

Compendium Reports

If a member distributes a research report covering six or more subject companies, the member is not obligated to include the disclosures required by the SRO Rules, provided that the report directs readers in a clear manner as to where they may obtain applicable current disclosures for all covered companies in written or electronic format. In this regard, a compendium report must provide a toll-free number to call or a postal address to write for the required disclosures. Electronic compendium research reports may instead include a hyperlink to the required

³⁹ NASD Rule 2711(h)(7) and NYSE Rule 472(k)(2)(ii).

disclosures. Paper research reports may also include a web address of the member where the disclosures are located.

While members are not obligated to include these disclosures in a compendium report so long as the report directs readers to where they may obtain the applicable current disclosures, members are encouraged to disclose in the compendium report the distribution of the member's ratings as required by NASD Rule 2711(h)(5) and NYSE Rule 472(k)(2)(iv). Because this disclosure is not unique to a particular subject company, this disclosure will be the same regardless of the number of subject companies covered in a compendium report.

Public Appearances

The SRO Rules require an analyst to disclose the following when making a recommendation during a public appearance: any financial interest held by the analyst or his or her household members; whether the firm and its affiliates, as of the end of the preceding month, held at least a 1% ownership interest in any class of common equity shares of the subject company; any other material conflict of interest of the analyst or firm of which the analyst knows or has reason to know; and whether the subject company is a client of the member or its affiliates. The term "public appearance" is defined and discussed above.

The SROs have received a number of questions regarding these provisions. First, some members asked whether the rule applies to analysts who make public appearances outside of the United States. The SRO Rules apply to any public appearance by a person who meets the definition of research analyst. They do not apply to employees of non-members unless they also are employees of the member.

Second, the SRO Rules⁴⁰ require a research analyst to disclose in public appearances if the analyst knows or has reason to know that the subject company is an investment banking client of the firm. As used herein, the term "client" is intended to include those clients from whom the member received revenues from investment banking services within the last 12 months, or for whom the member expects to provide investment banking services in the next three months, as disclosed in the most recent research report.

Third, several members have inquired whether the public appearance disclosures must be made during an extemporaneous radio or television interview when the research analyst does not possess the required disclosure information. If an analyst cannot make all of the required disclosures during a public appearance then the analyst must decline to make a recommendation or offer an opinion.

A related question is whether a research analyst has complied with the Rules if he or she makes all of the required disclosures during an interview, but the media outlet edits out the disclosures when all or part of the appearance is broadcast. The SROs cannot control the editorial decisions of the media. An analyst will not violate the Rules if he or she makes all of the mandated disclosures with a good faith belief, based on discussions with the media outlet, that those disclosures will be included whenever the appearance is broadcast or rebroadcast. However,

⁴⁰ See NASD Rule 2711(h)(2)(B) (which requires disclosure if the research analyst knows or has reason to know that the subject company is a "client" of the member or its affiliates) and NYSE Rule 472(k)(1)(ii) (which requires disclosure if the associated person knows or has reason to know that the subject company is an "investment banking services client" of the member, member organization or one of its affiliates).

when an analyst or a member is aware that a particular media outlet has previously edited out the required disclosures, the SROs expect that an analyst will decline subsequent appearances, absent assurances that the disclosures will not be edited out.

Fourth, members have asked whether the required disclosures may appear in a graphics box or a "scroll" across the screen in lieu of oral disclosures during a television or other video appearance. Such disclosure would satisfy the Rules, provided the graphic includes all of the required information presented in a prominent and readable format during the time of the appearance.

Finally, members have asked for guidance about the types of records that they should maintain to demonstrate compliance with the public appearance provisions of the Rules. Members must maintain records of appearances on television, radio or the Internet that are sufficient to record the statements made by a research analyst. These records may include a transcript or an audio or video tape of such an appearance.

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Executive Representative
Investment Banking
Legal & Compliance
Operations
Research
Senior Management

KEY TOPICS

Advertising
Investment Banking
Research Reports

GUIDANCE

Research Analysts and Research Reports

NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest

Executive Summary

In July 2002, NASD and the New York Stock Exchange (together, the SROs) issued a joint memorandum (the July 2002 Joint Memo) that provides interpretive guidance on NASD Rule 2711 (Research Analysts and Research Reports) and the research analyst provisions of NYSE Rules 351 and 472.¹ Since that time, the SROs have amended their rules governing research analysts and research reports,² and members have raised additional questions regarding these rules.

Accordingly, the SROs are issuing a second joint memorandum that provides further interpretive guidance to the research conflict of interest rules. Attachment A is the new joint memorandum. Attachment B is the current version of Rule 2711 for reference. Unless otherwise noted in the new joint memorandum, the guidance included in the July 2002 Joint Memo continues to apply.

Questions/Further Information

Questions or comments concerning this Notice may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-4623; or Philip Shaikun, Associate General Counsel, RPO, at (202) 728-8451.

Endnotes

¹ See Notice to Members 02-39 (July 2002).

² See Notice to Members 03-44 (July 2003).

04-18

New York Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

Information Memo

Member Firm Regulation



Number 04-10
March 9, 2004

ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS,
RESEARCH, COMPLIANCE, LEGAL, AND INVESTMENT
BANKING DEPARTMENTS

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: AMENDMENTS TO DISCLOSURE AND REPORTING
REQUIREMENTS

On July 29, 2003, the Securities and Exchange Commission ("SEC") approved further amendments to Exchange Rule 472 ("Communications with the Public"), and amendments to Rule 351 ("Reporting Requirements"), Rule 344 ("Supervisory Analysts"), and Rule 345A ("Continuing Education for Registered Persons").¹ The SEC also simultaneously approved comparable amendments to NASD Rule 2711 ("Research Analysts and Research Reports"), Rule 1120 ("Continuing Education Requirements") and new Rule 1050 ("Registration of Research Analysts") (collectively NYSE and NASD Rules are referred to as the "SRO Rules").

NYSE and NASD have prepared a Joint Memorandum (see attached Exhibit A) that provides clarification and interpretive guidance to the SRO Rules (see attached Exhibit B for NYSE Rules).

Questions regarding this Memo may be directed to William Jannace at 212-656-2744 or Donald van Weezel at (212) 656-5058.

Salvatore Pallante
Executive Vice President

Attachments

¹ See Securities Exchange Act Release No. 48252 (July 29, 2003), 68 FR 45875 (August 4, 2003) (SR-NYSE-2002-49).



**JOINT MEMORANDUM
OF
NASD AND THE NEW YORK STOCK EXCHANGE**

Discussion and Interpretation of Rules Governing Research Analysts and Research Reports (NASD Rule 2711 and NYSE Rules 351 and 472)

Background

This is a follow up to the joint memorandum issued by NASD and the New York Stock Exchange (the "SROs")¹ in July of 2002 (the "July 2002 Joint Memo") that provided interpretive guidance on NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to NYSE Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements") (collectively, the "SRO Rules").²

In July 2003, the Securities and Exchange Commission ("SEC") approved further changes to the SRO Rules that imposed new requirements on members³ and made other changes necessary to comply with research analyst provisions of the Sarbanes-Oxley Act of 2002 (the "July 2003 Amendments").⁴ This joint memorandum serves two purposes. First, the memorandum provides further clarification of previously issued interpretive guidance in light of the July 2003 Amendments. Second, it provides further interpretive guidance on the SRO Rules and responds to common questions that members have asked since the July 2002 Joint Memo was issued.

Continued Applicability of July 2002 Joint Memo

Members have inquired whether the guidance provided in the July 2002 Joint Memo continues to apply given the July 2003 Amendments. Unless otherwise noted below in this memorandum, the guidance in the July 2002 Joint Memo continues to reflect the SROs' interpretations of the SRO Rules. This memorandum is organized by subject matter and any change to the previous guidance in the July 2002 Joint Memo is noted in the applicable section.

¹ See NASD Notice to Members 02-39 (July 2002) and NYSE Information Memo No. 02-26 (June 26, 2002), both of which included a Joint Memorandum.

² See SEC Release No. 34-45908 (May 10, 2000), 67 Fed. Reg. 34968 (May 16, 2002).

³ For purposes of the NYSE Rules, the term "member" as used in this Joint Memorandum refers to both members and member organizations of the NYSE.

⁴ See SEC Release No. 34-48252 (July 29, 2003), 68 Fed. Reg. 45875 (Aug. 4, 2003).

Applicability of Registration and Continuing Education Requirements to Fixed Income Research Analysts

Members have inquired whether the new registration and continuing education requirements for research analysts⁵ apply to research analysts that only produce research on fixed income securities. As a general matter, the research analyst registration requirements and continuing education requirements apply only to analysts that are the subject to the SRO Rules. That is, these requirements apply only to associated persons that are primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on such a research report. The requirements do not apply to research analysts that only produce research reports on fixed income securities that are not “equity securities” as defined in Section 3(a)(11) of the Securities Exchange Act of 1934.

Definition of “Research Report”

As of September 29, 2003, the term “research report” is defined as “a written or electronic communication that includes an analysis of equity securities or individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.”⁶ Previously, the definition also required that the communication include a recommendation. That requirement was deleted in order to conform the SRO Rules to the definition of “research report” in the Sarbanes-Oxley Act.

While the SRO Rules no longer require that a research report contain a recommendation as a determining criteria, the analysis described in the July 2002 Joint Memo generally still applies. Although the issue of whether a communication is a research report still is determined by the individual facts and circumstances surrounding a particular communication, the list of exceptions in the July 2002 Joint Memo that are not generally “research reports” still applies under the new definition. Members should be aware that a disclaimer inserted into a communication with the public that indicates that the communication does not contain information sufficient upon which to base an investment decision has no relevance as to whether the communication falls within the definition of research report and could be misleading in certain circumstances.

Members have inquired whether a client communication that analyzes or recommends individual stocks would be considered a “research report” if it is written by an employee, such as a registered representative, who does not hold the title of “research analyst” and does not work in the member’s research department. To clarify this issue, the SROs are adopting the interpretation issued by the SEC with respect to Regulation AC: a client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to

⁵ NASD Rules 1050 and 1120 and NYSE Rules 344 and 345A

⁶ NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).

at least 15 persons. This conclusion applies even if the author of the communication does not hold the title of "research analyst" and does not work in the member's research department.

The SROs also are adopting the SEC interpretation regarding periodic reports and other communications prepared for investment company shareholders or discretionary investment account clients.⁷ Communications that discuss individual securities in the context of a fund's or account's past performance or the basis for previously made discretionary investment decisions (such as a manager's discussion of fund performance in a mutual fund shareholder report) are generally excluded from the definition of "research report."

Likewise, an investment company portfolio manager that prepares these types of communications would not be considered a "research analyst" for purposes of the SRO Rules even if he or she were registered with a member. However, if such a portfolio manager prepares communications that meet the definition of "research report" and do not fall within the exception noted above, those communications will be subject to the SRO Rules and the portfolio manager will be regarded as a research analyst.

Quantitative and Technical Research Reports

The SROs have continued to receive inquiries as to whether quantitative or technical research reports fall within the definition of "research report" under the SRO Rules. The July 2002 Joint Memo excluded from the definition of "research report" communications of "technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price." The SROs do not believe it is consistent with the purposes of the SRO Rules to exclude technical analysis of individual securities. Such an interpretation could allow a research analyst to provide coverage of a security of an issuer with which the member has an investment banking relationship or where the analyst may have a personal financial interest without the disclosures that would identify such potential conflicts. These are some of the very conflicts the SRO Rules are intended to address. The SEC similarly excluded from the definition of "research report" in Regulation AC only sector, index and industry technical analysis.

The SROs believe the term "quantitative" as applied to research can be subject to various interpretations. Indeed, many research reports typically labeled "quantitative" by members can and do raise conflicts concerns. In this regard, not all mathematical models are inherently objective. Many such models are based on subjective formulas where a person or persons selects or can change the inputs: for example, particular performance ratios or consensus earnings estimates. The SROs are concerned that such models based on subjective formulas could be manipulated to produce a desired result, depending on the ratios or other criteria selected, the universe of securities, and the formula employed.

Consequently, the SROs do not believe it appropriate to categorically exclude any "quantitative" research from the scope of the SRO Rules. Nonetheless, the SROs do recognize that certain "quantitative models" devised by members may sufficiently guard

⁷ See SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

against any potential conflicts of interest to render them outside the definition of a “research report.” Thus, reports generated by formulas that are generally free of subjective inputs from an employee of a member may fall outside the definition of research report. However, the SROs believe that such a determination is best considered on a case-by-case basis.

Definition of “Public Appearance”

The SRO Rules define the term “public appearance” as “any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security.”⁸ Members have inquired whether password-protected conference calls or web casts in which a research analyst provides his or her opinion on individual companies or securities constitute public appearances for purposes of the SRO Rules.

As discussed above, and consistent with SEC Regulation AC, an analysis of individual securities or companies prepared for a specific person or a limited group of fewer than 15 persons is not considered to be a “research report.”⁹ The SROs believe that a similar standard is appropriate to apply to public appearances. Thus, an appearance before persons representing 15 or more separate investors will be regarded as a public appearance for purposes of the SRO Rules. However, the SROs would not require an analyst to make the disclosures required for public appearances in a password protected web-cast, conference call or similar event with more than 15 existing customers (e.g. individuals or entities), provided (1) all of the call participants previously received the most current research report or other documentation that included the required disclosures and (2) the research analyst making the public appearance corrects and updates any disclosures in the research report that are inaccurate, misleading or are no longer applicable. If representatives of the media attend the public appearance, the analyst must make the required disclosures. Members also are reminded that such appearances are subject to appropriate record keeping requirements, which in this case must include a record of all attendees at the public appearance.

Application of SRO Rules to Third-Party Research

The July 2002 Joint Memo included guidance on the applicability of the SRO Rules to third-party research distributed by a member. That memo states that if a member distributes research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party (other than through a soft dollar arrangement), it must accompany this research with the following “Third-Party Research Disclosures,” if applicable:

⁸ NASD Rule 2711(a)(4) and NYSE Rule 472.50.

⁹ See SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

- the member's and its affiliates' ownership of the subject company's securities;¹⁰
- that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;¹¹
- that the member was making a market in the subject company's securities at the time the research report was published;¹² and
- any other actual, material conflict of interest of the member known at the time of distribution of the research report.¹³

Absent a soft dollar arrangement, when a member distributes another member's research report, the distributing member must include the Third-Party Research Disclosures, while the member that prepared the report must comply with all of the disclosures required by the SRO Rules.

This memorandum addresses three questions that have arisen with respect to third-party research. (1) Are any of the new disclosures required by the recently amended SRO Rules now included in the required Third-Party Research Disclosures? (2) What factors determine whether a research report is considered to be the product of the member rather than its affiliate or an independent third party? (3) Do different rules apply to the distribution of non-member affiliate research and independent third-party research?

Disclosure of Non-Investment Banking Compensation

The July 2003 Amendments to the SRO Rules require a member to provide additional disclosure in research reports regarding compensation that it or its affiliates receive from the subject company. The SRO Rules now require a member to disclose if it received compensation for products or services other than investment banking. This information must be current as of the end of the month preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month). A member also must disclose if the analyst or an employee with ability to influence the substance of the research report has actual knowledge as of the date of publication that the member received such compensation.

¹⁰ NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)c.

¹¹ NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(i)a.

¹² NASD Rule 2711(h)(8) and NYSE Rule 472(k)(1)(i)b.

¹³ NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(iii)d.

In addition, the July 2003 Amendments also generally require the disclosure in research reports of receipt of non-investment banking compensation received by a member's *affiliates*. However, a member is not required to disclose the receipt of non-investment banking compensation by its affiliates if the member has implemented procedures prescribed by NASD Rule 2711(h)(2)(v)(b) and NYSE Rule 472(k)(1)(iii)a.2. Under these provisions, a member is not required to disclose an affiliate's non-investment banking compensation from a subject company if the member maintains and enforces policies and procedures to wall off research analysts and employees with ability to influence the substance of research reports from receiving information about such compensation.

Finally, a member must disclose if the subject company is or has been during the preceding 12-month period a client of the member. In such cases, the member also must disclose the types of services provided to the subject company, categorized as either investment banking services, non-investment banking securities-related services, or non-securities services.

The SROs will not require a member that distributes third-party research to separately disclose non-investment banking compensation received by the member or an affiliate, unless receipt of that compensation represents an actual, material conflict of interest of the member known at the time of the distribution of the research report. Similarly, a member need not disclose the existence of a client relationship with the subject company, unless such relationship already falls within the current Third-Party Research Disclosures, such as managing or co-managing a public offering of the subject company within the previous 12 months. In sum, members are required to make the same disclosures under the SRO Rules when distributing third-party research as they were required to make prior to the July 2003 Amendments, recognizing that the receipt of non-investment banking compensation can, under certain circumstances, represent a material conflict of interest.

Member vs. Third-Party Research Report

The determination of whether a research report is considered a product of the member or of a third party depends on: (1) whether the report appears to be the product of a member or (2) whether a "research analyst" (as defined by the SRO Rules) associated with a member is involved in producing the research report. It is irrelevant to the analysis where a report is distributed -- domestically or internationally -- or to whom it is distributed, or on which market the subject company's securities are traded.

The SROs consider research reports that meet either of these above factors to be reports produced by the member that must meet all of the SRO Rules' requirements. Thus, for example, if a member issues a "globally-branded"¹⁴ research report, all of the SRO Rules would apply to that report. Similarly, if a member adapts, alters or distributes a research report produced by an affiliate or an independent third party in such a way that an investor reasonably could believe it to be the product of the member, rather than that of the affiliate or independent third party, then

¹⁴ A "globally-branded" research report refers to the use of a single marketing identity that encompasses the member and its affiliates.

the report will be considered to be the member's own and subject to all of the SRO Rules. A research report prepared by a "mixed research team" that includes at least one person who meets the definition of "research analyst" and is associated with the member also would be considered a report produced by the member.

Independent and Non-Member Affiliate Research Reports

A research report distributed by a member that is produced either by an independent third party or non-member affiliate must include the Third-Party Research Disclosures. In this regard, the interpretations of the SRO Rules treat independent third-party research and non-member affiliate research the same, with one exception. A member that makes a non-member affiliate's research report available to its customers upon request or through its website or a website maintained by the member must include the Third-Party Research Disclosures. However, these disclosures do not apply to independent third-party research that is similarly made available to customers upon request or through a member-maintained website.

Subject Company Review of Research

The SRO Rules require legal or compliance personnel (the "Gatekeepers") to intermediate certain communications between a member's Research Department and companies that are the subject of a research report. Specifically, the SRO Rules¹⁵ provide:

- That a member **may not submit a research report to the subject company prior to publication**, except for the **review of sections of a draft** of the research report solely to verify facts. Members may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.
- Prior to **submitting any sections of the research report to the subject company**, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.
- If after submission to the subject company, the Research Department intends to change the proposed rating or price target, **the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change**. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

The SRO Rules prohibit the submission of a research report, in its entirety, to the subject company prior to its publication, even if the research summary, research rating or price

¹⁵ NASD Rule 2711(c) and NYSE Rule 472(b)(4).

target has been redacted from the report. Providing a report with such information redacted could still enable a subject company to discern the tenor of the report and possibly the company's rating or even price target. The rules only permit submission of sections of a report to verify facts in that section. Submission of facts interspersed with opinions, estimates, conclusions and other non-factually based information by the research analyst violates the SRO Rules. Members should consider submitting to the subject company a separate document containing a summary of facts for which the member seeks verification.

The SROs also wish to clarify the role of the Gatekeepers for purposes of these Rules. Gatekeepers may not merely rubberstamp changes in research reports after sections of the report have been submitted to the subject company. Gatekeepers must review the report and changes thereto, and document the basis for approval. In instances where a change in a rating or price target is to be made, the Gatekeepers must review the written justification provided by the research department, compare it with any comments received from the subject company regarding sections of the draft that had been submitted for factual verification, and conduct such follow-up inquiry as is necessary to establish a reasonable and causal basis for the change.

Restrictions on Publishing Research

Quiet Periods and Blackout Periods

The SRO Rules impose "quiet periods" during which a member may not publish a research report or make a public appearance regarding a subject company for which the member acted as manager or co-manager of a public offering of securities. The SRO Rules impose on managers and co-managers a 40 calendar-day quiet period following an initial public offering ("IPO"), and a 10 calendar-day quiet period (subject to certain exceptions) following a secondary offering.¹⁶ The SRO Rules also impose a 25 calendar-day quiet period on members that have agreed to participate as an underwriter or dealer (other than as a manager or co-manager) of an issuer's IPO.¹⁷

The SRO Rules also prohibit a member that has acted as manager or co-manager of a securities offering from publishing a research report or making a public appearance concerning a subject company 15 days prior to or after the expiration, waiver or termination of a "lock-up" or similar agreement that restricts the sale of securities after the completion of a securities offering.¹⁸ Finally, the SRO Rules impose a "blackout period" that prohibits a research analyst from purchasing or selling the securities of a company that the analyst follows for a period beginning 30 days before and ending 5 days after the publication of a research report on the subject company or a change in a rating or price target of the company's securities.¹⁹

¹⁶ NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) and (2).

¹⁷ NASD Rule 2711(f)(2) and NYSE Rule 472(f)(3).

¹⁸ NASD Rule 2711(f)(4) and NYSE Rule 472(f)(4).

¹⁹ NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).

Exceptions to the Quiet Periods and Blackout Periods

The SRO Rules allow a member to publish a research report or make a public appearance during the restricted periods concerning the effects of significant news or a significant event that occurs during those periods, provided that the member's legal and compliance department authorizes publication of the report before it is issued or the public appearance before it is made.²⁰ Members have asked for additional guidance regarding this exception.

The significant news or event exception is intended to allow for coverage in research reports and public appearances of news or events that have a material impact on, or cause a material change to, a company's operations, earnings or financial condition, and that generally would trigger the filing requirements of SEC Form 8-K. Examples might include the rejection of a patent or drug application; a labor strike; resignation of a chief executive officer or chief financial officer; or a publicly-announced investigation into company activities by a regulator. Members have asked whether a subject company's announcement that it exceeded, met or fell short of expected earnings would constitute significant news permitting an exception to the quiet and blackout periods. As a general matter, the SROs would not regard an announcement about earnings to fall within the exception because an earnings announcement itself generally is not a causal event or news item that materially affects a company's operations, earnings or financial condition. There may be cases, however, where significant news or a significant event has caused the company to exceed or fall short of expected earnings that may permit an exception and allow a member to issue a research report within the quiet or blackout period to the extent that it discusses the news item that affected earnings.

Additionally, members have inquired whether the SRO Rules are intended to limit the content of a research report that is issued during a quiet or blackout period due to a significant event or news item to the effects of the event or news, or whether such a report may discuss any other issues related to the subject company. A research report issued pursuant to this exception must be limited to discussing the effects of the news or event that triggered the exception. However, the report may contain or update a price target, rating or recommendation concerning the subject company's securities.

Members also have inquired whether the private placement of a subject company's equity would be a significant event that would allow an exception from the SRO Rules' quiet period provisions. In general, the SROs would not regard the issuance of such securities as a significant event allowing a member to publish research during a quiet period. The private placement of securities is within the issuer's control, and thus not the sort of unforeseen news or event that the SRO Rules contemplated in allowing an exception to the quiet periods.

²⁰ NASD Rules 2711(f)(1)(B)(i), 2711(f)(4) and 2711(g)(2)(B), and NYSE Rules 472(e)(4)(ii) and 472(f)(5).

Application of Quiet Periods to Unregistered Offerings

Members further have asked whether the rules imposing quiet periods following secondary offerings and before and after waivers of lock-up agreements apply to non-registered securities offerings. In general, the quiet period following a secondary offering and before and after the waiver of a lock-up agreement applies only to offerings of securities that must be registered for offer or sale in the United States. Thus, quiet periods would not apply to private placements of Rule 144A securities and Regulation S offerings.

Lock-up Agreements and Waivers

Finally, members have inquired as to what date a lock-up agreement is considered waived for purposes of applying the 15-day quiet period before and after the waiver of a lock-up agreement. The 15-day quiet period is triggered based on the first date a shareholder that is subject to a lock-up agreement may sell his or her shares pursuant to the waiver. It is *not* triggered based on the date when an underwriter or other party notifies shareholders that a waiver has been granted. It is also not triggered based on the date when an underwriter or other party registers a securities offering under the federal securities laws.

Since SRO rules do not require lock-up agreements, and since parties to such agreements often are outside the jurisdiction of the NASD or NYSE, the SROs typically cannot determine whether a specific act or contractual provision in a lock-up agreement constitutes a waiver for the purposes of the SRO quiet periods. However, the SROs remind members that the purpose of the quiet period is to prevent members from publishing favorable research that is intended to drive up the price of an issuer's stock for the benefit of certain shareholders who will no longer be subject to a lock-up agreement. Accordingly, the SROs will closely examine research that is issued or otherwise distributed around the time that an underwriting client of the member sells, or first becomes eligible to sell, a significant volume of the subject company's shares.

Personal Trading Restrictions

Members have raised a number of issues with regard to the application of the personal trading restrictions under the SRO Rules.²¹

Trading Against Recommendations

The SRO Rules generally prohibit a research analyst account²² from purchasing or selling any security or option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the

²¹ NASD Rule 2711(g) and NYSE Rule 472(e).

²² A "research analyst account" includes any account in which a research analyst or member of the research analyst's household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. NASD Rule 2711(a)(6). See also NYSE Rule 472.40.

member.²³ Members have inquired as to whether this restriction applies only to recommendations regarding securities of the subject companies covered by the research analyst making the trade, or whether this restriction applies to the recommendations regarding all subject companies covered by the member. This restriction only applies to trades in securities of subject companies covered by the particular research analyst.

Dividend Reinvestment Programs

Members have inquired whether the SROs regard purchases of securities through a dividend reinvestment plan ("DRIP") to be subject to the "blackout periods" on personal trading. The SRO Rules generally prohibit a research analyst account from purchasing or selling any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending 5 calendar days after the publication of a research report concerning the company or a rating or price target of the company's securities.

DRIPs typically are plans that allow a participant to reinvest dividends paid on securities held by the participant in the same class of securities of the issuer. Most DRIPs have two components. First, they automatically reinvest cash dividends in the purchase of additional shares of the same securities held by the participant. Second, they permit periodic discretionary cash investments in the same securities. The SROs would not regard automatic reinvestments of dividends in securities of a subject company as covered by the personal trading restrictions' blackout periods. The SROs would reach the same conclusion with respect to automatic reinvestments of dividends in investment funds that are subject to the personal trading restrictions.²⁴ However, any discretionary cash investments in a subject company's securities, or securities of an investment fund that is subject to the personal trading restrictions, that are made through a DRIP would be subject to the blackout periods.

Short Sales

Where a research analyst has a "sell" (or similar) rating on a subject company's securities, establishes a short position with regard to the securities and later covers the short position, the SROs would regard the covering of the short position as trading contrary to his or her recommendation, since as part of that transaction the analyst would have to buy the securities. Moreover, an analyst may not establish a short position on a rated security during an applicable blackout period.

²³ NASD Rule 2711(g)(3) and NYSE Rule 472(e)(3).

²⁴ The SRO Rules exclude from the personal trading restrictions investments in registered diversified investment companies and other investment funds that meet certain criteria. See NASD Rule 2711(g)(5) and NYSE Rule 472(e)(4)(v) and (vi).

Trades During "Neutral" Ratings

Some members have inquired whether a research analyst may buy or sell a subject company's securities if the analyst has assigned a "neutral" or "market perform" (or similar) rating to such securities. The SROs regard these (or similar) ratings as the same as a "hold" rating.

Accordingly, a research analyst may neither buy nor sell a subject company's securities to which he or she has assigned a hold (or similar) rating.

Changes in Earnings Estimates

Several members have inquired whether the personal trading blackout period would be triggered if a research analyst changed his or her earnings estimates for a subject company, assuming that the change did not coincide with the issuance of a new research report and did not result in a change in the rating or price target for the subject company's securities. These circumstances would not trigger the personal trading blackout period.

Trading Restrictions on Supervisors of Research Analysts

The SRO Rules now require a member's legal or compliance personnel to pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee.²⁵ The SRO Rules also have been amended to make clear that the research analyst personal trading restrictions do not apply to "blind trusts" that are controlled by a person other than the research analyst or a member of the analyst's household where neither the analyst nor a household member knows of the account's investments or transactions.²⁶ Likewise, the requirements for legal or compliance personnel to pre-approve securities transactions of supervisory personnel do not apply to transactions within "blind trusts" of which supervisory personnel are the beneficiaries.

The SROs have been asked how the requirement that legal or compliance personnel pre-approve the trades of supervisory personnel applies to an account that is managed by a third party (either an outside manager or an in-house account). As a general matter, the SROs would consider a member to have met its obligations to pre-approve a supervisor's transactions in a managed account where the supervisor has no discretion or control if the member has policies and procedures to monitor the managed account's trades. If such policies and procedures are in place, the SROs would not require legal or compliance personnel to pre-approve each transaction made within the managed account.

²⁵ NASD Rule 2711(g)(6) and NYSE Rule 472(e)(5).

²⁶ NASD Rule 2711(a)(6) and NYSE Rule 472.40.

Disclosure Issues

In reviewing members' research reports, the SROs have found that some reports fail adequately to make the disclosures required by the SRO Rules.²⁷ This section of the joint memorandum is intended to highlight some of the more common problems that the SROs have found.

Prominence of Disclosures

The first page of a research report must include the disclosures required under the SRO Rules or must refer the reader to the pages on which such disclosures are found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent.²⁸

References on the front page of a research report to where disclosures are located must be separated from the report's body text, and in larger font size than the body text. For example, many firms are enclosing the references to disclosure location in a box on the first page of the report that enhances the prominence of the disclosure reference.

A notation on the first page that refers readers to the "end of the report" rather than the specific page is not sufficient. The SRO Rules require a reference to the specific page number or to the last page of the report or to a specific section of the report, such as the appendix. In addition, members may use hyperlinks to direct the reader to the required disclosures only in electronically transmitted reports and compendium reports²⁹ or as an additional point of reference in written reports.

Regardless of where the required disclosures are placed, they should be labeled using a heading such as "Important Disclosures" or "Required Disclosures" so as to be clearly identifiable. Similarly, the font size of the type must be large enough so that the disclosures are clearly legible and distinguishable from body text, other disclosures or disclaimers.

The "Important (or Required) Disclosures" section must include all applicable required textual disclosures (e.g., market making, ownership positions, compensation, etc.), the price chart, the ratings description, ratings distribution (by number of investment banking clients), the valuation methodology, price target and related risk factors description, in a clear and logical order. As an example, related disclosures such as ratings systems and ratings distributions should be in close proximity.

²⁷ See NASD Rule 2711(h) and NYSE Rule 472(k)(1).

²⁸ NASD Rule 2711(h)(10) and NYSE Rule 472(k)(1).

²⁹ A "compendium report" is a research report that covers six or more subject companies. See NASD Rule 2711(h)(11) and NYSE Rule 472(k)(1).

Disclosure of Officer or Director Positions

A member is required to disclose in research reports if the research analyst or member of his or her household is an officer, director, or advisory board member of the recommended issuer.³⁰ This disclosure, if applicable, must include the position held by the research analyst or household member.

Conditional or Indefinite Language

Members are required to disclose in research reports if they own 1% or more of a subject company's equity securities and if they make a market in a subject company's securities at the time the research report is issued. Members also must disclose if the member or its affiliates: (a) managed or co-managed a public offering of equity securities for the subject company in the past twelve months; (b) received compensation for investment banking services from the subject company in the past twelve months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.³¹

Members may not use conditional or indefinite language in required disclosures, such as "may have a position" or "may make a market" in any of the subject company's securities, or that the reader "should assume" that the firm or its affiliates engaged in investment banking business with a subject company. The required disclosures with respect to past receipt and expectation of investment banking services related compensation must be made separately, if applicable. For example, a member may not disclose that it "received compensation for investment banking services in the past twelve months or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months." Such disclosure lacks the specificity required by the SRO Rules.

Use of Disclaimers

Research reports may not include general or specific disclaimers that contradict or are inconsistent with disclosures required by SRO Rules. For example, it is inconsistent for a research report to disclose that the member makes a market in the specific securities that are the subject of the research report and separately to disclose generally that the member may make a market in some or all of the securities mentioned in the report.

The presence of disclosures and disclaimers not required by the SRO Rules in close proximity to the disclosures required by the SRO Rules may cause confusion and detract from their readability. Therefore, any disclosures or disclaimers not required by the SRO Rules must be clearly separated and appropriately labeled. If the required disclosures are placed near non-required disclaimers and disclosures, each set of disclosures and

³⁰ NASD Rule 2711(h)(3) and NYSE Rule 472(k)(1)(iii)c.

³¹ NASD Rule 2711(h)(1)(B), (h)(2)(A)(ii), and (h)(8); NYSE Rule 472(k)(1)(i)a., b., and c.

disclaimers must be clearly labeled, e.g., "Important (or Required) Disclosures," "Other Disclosures," and "Disclaimers." The disclosures required by the SRO Rules also must be separate from disclosures required by foreign jurisdictions.

Use of Stock Symbols

Members may not use stock symbols in the "Important Disclosures" section of the report unless the reader is specifically directed to where in the report the subject companies represented by the symbols are identified by proper names.

Disclosure of Ratings Distributions and Price Charts

The SRO Rules allow members to use any ratings system they deem appropriate in their research reports, so long as they are accompanied by a clear definition of the meaning of each rating used in the system.³² The SRO Rules require a member to disclose in each research report the percentages of all securities rated by the member to which the member has assigned a "buy", "hold/neutral" or "sell" rating.³³ The SRO Rules also require each report to disclose the percentage of subject companies within each of these three rating categories for whom the member has provided investment banking services within the previous 12 months.³⁴

If a member utilizes a ratings system that employs terms different than "buy," "hold/neutral" and "sell," the member must determine, based on its own ratings system, into which of these three categories its ratings fall. The research report must use the terms "buy," "hold" and "sell" in making these ratings distributions disclosures. However, if a member uses a ratings system that employs terms other than "buy," "hold/neutral" and "sell," the member may combine its own ratings terms with those categories required by the SRO Rules to make the ratings distribution disclosures (e.g., "buy/overweight," "hold/equalweight and "sell/underweight").

The SRO Rules specify that information regarding ratings distributions must be current as of the most recent calendar quarter end (or the second most recent calendar quarter end if the publication date is less than 15 days after the most recent calendar quarter).³⁵ The SRO Rules do not specify, however, what time period the ratings distribution must cover. Some members have noted that they do not regularly issue ratings and thus were uncertain as to how far back the ratings distribution universe must extend. In general, the ratings distribution should include all current ratings of the member. However, if the member does not issue new ratings on a relatively frequent basis, the SROs will consider a member to

³² NASD Rule 2711(h)(4) and NYSE Rule 472(k)(1)(i)f.

³³ NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(1)(i)g. and 472.70.

³⁴ NASD Rule 2711(h)(5)(B) and NYSE Rule 472(k)(1)(i)g. and 472.70.

³⁵ NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.

have complied with the ratings distribution disclosure requirements if the distribution includes ratings that the member has issued within the past 12 months.

If a research report does not contain any rating – express or implied – of the subject company’s stock, the report is not required to include the ratings distribution information required by the SRO Rules. In addition, if the report does not include either a rating or a price target for the subject company’s stock, the report is not required to include a price chart.³⁶

³⁶ See NASD Rule 2711(h)(6) and NYSE Rule 472(k)(1)(i)h.

Comparison of Global Settlement and SRO Rules		
Subject	Global Settlement	SRO Rules
Reporting Lines	Undertaking I.1	NASD Rule 2711(b)(1) and NYSE Rule 472(b)(1)
	Research may not report directly or indirectly through investment banking. Head of research may report to person to whom investment banking head also reports, provided that such person has no direct responsibility for investment banking activities.	No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no person engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.
Definition of "Research Report"	Undertaking I.1.e	NASD Rule 2711(a)(8) and NYSE Rule 472.10(2)
	Limited to communications to U.S. investors. Excludes quantitative analysis concerning sectors, industries or indexes. Also excludes analyses for current customers (without limit).	Not limited to communications to U.S. investors. Does not exclude quantitative analyses, although interpretations exclude analyses of sectors, industries or indexes. Current customer analysis exclusion limited to 15 customers.
Legal/Compliance	Undertaking I.2	N/A
	Research must have its own dedicated legal and compliance staff, who may be part of the firm's overall compliance/legal infrastructure.	No similar requirement.
Budget	Undertaking I.3	NASD Rules 2711(d)(2) and (h)(2)(A)(i)(a) and NYSE Rules 472(h)(2) and (k)(1)(ii)a.2
	Research budget must be determined by senior management without input from investment banking, and without regard to investment banking revenues. Firm revenues as a whole may be considered. Audit Committee must ensure compliance with this provision annually.	A firm's overall profitability may be considered in determining the compensation component of a firm's research budget, but this component may not be based on profitability of firm's investment banking department or division. In addition, if a research analyst's compensation is based upon the firm's overall profitability which includes investment banking revenues, this fact must be disclosed.
Physical Separation	Undertaking I.4	N/A
	Research and investment banking must be physically separated.	No similar requirement.

Subject	Global Settlement	SRO Rules
Compensation	Undertaking I.5	NASD Rule 2711(d) and NYSE Rule 472(h)
	Compensation of research personnel must be determined exclusively by research management and firm's senior management based on following principles: (A) Investment banking will have no input. (B) Compensation may not be based on IB revenues or results (firm results OK). (C) A significant portion of the lead analyst's compensation must be based on the quality and accuracy of the lead analyst's research, analysis, ratings and price targets. (D) Certain other factors may be taken into consideration. (E) Compensation criteria determined by research management and firm's senior management (not including IB) and set forth in writing in advance. (F) Research management must document the basis for such compensation. Compensation committee of firm's parent company will conduct annual compliance review.	Analysts may not receive compensation based on a specific investment banking transaction. Lead analysts' compensation must be reviewed and approved by a compensation committee that does not have any representation from the IB department. The committee must consider the following factors: (A) the analyst's individual performance, including his productivity and the quality of his research; (B) the correlation between the analyst's recommendations and the stock price performance; and (C) the overall ratings received from clients, sales force, and peers independent from the firm's IB department, and other independent ratings services. The analyst's contributions to IB department may not be considered. Documentation and attestation requirements.
Evaluations	Undertaking I.6	NASD Rule 2711(d)(2) and NYSE Rule 472(h)(2)
	Evaluations of research personnel will not be done by, nor will there be input from, investment banking.	Research analyst compensation review committee may not have representation from investment banking.
Coverage	Undertaking I.7	NASD Rules 2711(b)(1) and (b)(3)(A) and NYSE Rules 472(b)(1) and (b)(3)(i)
	Investment banking will have no input into company-specific coverage decisions (initiation or termination), and IB revenues will not be taken into account in making company-specific coverage decisions. Provision does not apply to industry sector coverage decisions.	No research analyst may be subject to the supervision or control of any employee of a member's investment banking department. In addition, any discussion regarding research coverage would have to be intermediated by legal and compliance.
Termination of Coverage	Undertaking I.8	NASD Rule 2711(f)(5) and NYSE Rule 472(f)(6)
	Requires a firm to provide a final research report when it decides to terminate coverage of a particular company. Firm must use the same means of disseminating the final report that it ordinarily uses. No final report is required if the prior coverage was purely quantitative. The report must be comparable to prior reports, unless impracticable. The report must disclose notice of termination and the rationale for the decision to terminate coverage.	Requires notice of termination if a member intends to terminate coverage of a subject company. Firm must use the same means of disseminating the final report that it ordinarily uses. The report must be comparable in scope and detail to prior reports and must include a final rating or recommendation unless impracticable. If impracticable to produce a final rating or recommendation, report must disclose the rationale for the decision to terminate coverage.

Subject	Global Settlement	SRO Rules
Prohibition on Soliciting Investment Banking Business	Undertaking I.9	NASD Rule 2711(c)(4) and NYSE Rule 472(b)(5)
	Research is prohibited from participating in efforts to solicit IB business. Among other things, research may not participate in pitches with prospective IB clients or have other communications with companies for the purpose of soliciting IB business.	Same rule.
Firewalls Between Research and Investment Banking	Undertaking I.10	NASD Rules 2711(b)(2) and (b)(3) and NYSE Rules 472(b)(2) and (b)(3)
	Sets forth detailed "firewall" restrictions regarding communications between research and investment banking during the period that research is assisting IB in selecting prospective IB clients. Allows research personnel to assist in confirming the adequacy of disclosures in offering documents and pricing of transactions subject to certain conditions. Allows research to attend widely attended conferences and firm meetings at which matters of general firm interest are discussed. Allows IB and research to discuss compliance issues in presence of internal compliance personnel. Allows communications between IB and research personnel not related to IB or research without restriction.	Generally requires written or oral communications between non-research and research personnel regarding the content of a research report to be documented and conducted through or in the presence of legal or compliance personnel. Non-research personnel may only review a research report to verify its factual accuracy or to identify potential conflicts of interest.
Road Shows	Undertaking I.11	NASD Rules 2711(c)(5) and (c)(6) and NYSE Rules 472(b)(6)
	Prohibits research personnel from participating in company or investment banking-sponsored road shows related to a public offering or other IB transaction. IB is prohibited from directing research personnel to engage in marketing or selling efforts to investors with respect to an IB transaction.	Same rule. Also prohibits research analysts from communicating with customers regarding investment banking transactions in presence of IB personnel or company management. Research analyst communications with customers or internal personnel regarding IB transactions must be fair and balanced.

Subject		Global Settlement	SRO Rules
Oversight	Undertaking I.12	N/A	
	Requires firms to create an oversight committee of research management to review changes in ratings or price targets, review reports to determine whether changes in ratings or price targets should be considered, and to monitor overall research report quality. Exceptions for quantitative analysis.	No similar requirement.	
Disclosure	Undertaking II.1	NASD Rule 2711(h) and NYSE Rule 472(k)(1)	
	Requires firms to disclose on first page of a research report, in addition to other disclosures required by rule, that firm does or seeks to do business with companies covered by its reports and that as a result, investors should be aware that conflicts of interest could affect the report's objectivity. Requires disclosure of availability of independent research for listed companies. Must disclose that investors should consider the report only as a single factor in making their investment decision.	The SRO Rules have more specific and comprehensive disclosure requirements than these. For example, the SRO Rules require a firm to disclose if it or an affiliate (a) managed or co-managed a public offering of securities for the subject company in the last 12 months, (b) received investment banking compensation from the subject company in the past 12 months, or (c) expects to receive or intends to seek investment banking compensation from the subject company in the next 3 months.	
Transparency of Analysts' Performance	Undertaking II.2	NASD Rules 2711(h)(4), (5) and (6) and NYSE Rules 472(k)(1)(i)(f), (g), and (h)	
	Requires firms to make available on their web sites after the conclusion of each quarter certain information regarding the analyst's research for each subject company, such as the date of the report, rating, price target, period within which price target is to be achieved, EPS forecast, and definitions of ratings.	Research analysts must disclose in research reports the meanings of the ratings used in the firm's ratings system, a percentage distribution of the buy, hold and sell ratings that the firm assigns to subject companies it covers, including the percentage of these companies that are firm IB clients, and a price chart that shows the movement of the subject company's stock price and the dates on which the analyst assigned or changed a rating or price target.	
Investor Education	Undertaking II.3	N/A	
	Requires firms to pay fine to pay for investor education pursuant to plan administered by SEC, NASD and NYSE, with remainder going to NASAA for same purpose.	No similar requirement.	

Subject		Global Settlement	SRO Rules
Applicability	Undertaking II.4	NASD Rule 2711(a)(8) and NYSE Rule 472.10(2)	
	Applies Undertaking restrictions only to research reports that are prepared by the firm and that related to either a U.S. company or a non-U.S. company for which the U.S. is a principal equity trading market. Applies coverage and disclosure requirements, above, to any report furnished by a firm to U.S. investors.	Definition of "research report" does not contain this limitation; thus, it includes research on non-U.S. companies. The SRO Rules require limited disclosures for reports prepared by foreign affiliates and other third-party research distributed to customers.	
Policies and Procedures	Undertaking II.5	NASD Rule 2711(i) and NYSE Rule 472(c)	
	Prohibits a firm from knowingly doing indirectly that which it cannot do directly under the Undertaking. Requires firms to adopt policies and procedures reasonably designed to ensure that a firm's associated persons do not seek to influence the contents of research reports for the purpose of obtaining investment banking business. Policies must instruct firm personnel to report violations of this proscription.	Members must adopt and implement procedures reasonably designed to ensure the member and its employees comply with the SRO Rules. Senior officer must attest that the member has adopted and implemented these procedures.	
Independent Monitor	Undertaking II.7	N/A	
	Requires each firm to retain at its own expense an independent monitor to review implementation of the Undertaking. Sets forth detailed rules governing how independent monitor will work.	No similar requirement.	
Independent, Third-Party Research	Undertaking III	N/A	
	Sets forth detailed requirements for firms to procure and make available for their clients independent research on listed companies that they cover (other than quantitative research).	No similar requirement.	
Restrictions on Communications with the Subject Company	N/A	NASD Rule 2711(c)(1) and (c)(2) and NYSE Rule 472(b)(4)	
	No similar provisions.	Members may not submit research reports to subject companies before their publication except to review the factual accuracy of a report, and subject to conditions.	

Subject	Global Settlement	SRO Rules
Prohibitions on Promises of Favorable Research	N/A	NASD Rule 2711(e) and NYSE Rule 472(g)(1)
	No similar provisions.	Members may not offer favorable research or a specific rating or price target, or threaten to change any research, rating or price target to induce the receipt of business or compensation.
Restrictions on Publishing Research	N/A	NASD Rules 2711(f)(1), (2), (3) and (4) and NYSE Rules 472(f)(1), (2), (3), (4) and (5)
	No similar provisions.	Members are subject to "quiet periods" during which they may not publish research and analysts may not make public appearances following initial and secondary offerings and around the termination, waiver or expiration of "lock-up" agreements, subject to certain exceptions.
Restrictions on Personal Trading by Analysts	N/A	NASD Rule 2711(g) and NYSE Rule 472(e)
	No similar provisions.	Research analysts face a number of restrictions on the trading of securities that they cover, such as prohibitions on trading against recommendations and trading blackouts around the time research is issued or ratings are changed.
Disclosure Requirements for Analyst Public Appearances	N/A	NASD Rule 2711(h) and NYSE Rule 472(k)(2)
	No similar provisions.	Research analysts must make disclosures when discussing stocks in public appearances, such as whether the member has received investment banking compensation from the issuer or the analyst has a financial interest in the issuer.
Other Disclosure Requirements for Research Reports	N/A	NASD Rule 2711(h) and NYSE Rule 472(k)(1)
	No similar provisions.	Members must disclose in research reports firm and analyst ownership of subject company securities and receipt of non-investment banking compensation from subject company.
Retaliation Against Analysts	N/A	NASD Rule 2711(j) and NYSE Rule 472(g)(2)
	No similar provisions.	Members are prohibited from retaliating against or threatening analysts as a result of adverse or unfavorable research or public appearance written or made by the analyst.
Registration of Research Analysts	N/A	NASD Rule 1050 and NYSE Rules 344 and 473

Subject	Global Settlement	SRO Rules
	No similar provisions.	Research analysts must pass qualification exams (Series 86/87) and register with their members' SRO. Certain exceptions for foreign and technical analysts.
Analyst Continuing Education Requirements	N/A	NASD Rule 1120 and NYSE Rule 345A
	No similar provisions.	Research analysts and their supervisors must satisfy certain continuing education requirements.

EXHIBIT 5

Exhibit 5 shows the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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Text of Proposed New FINRA Rule

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2200. COMMUNICATIONS AND DISCLOSURES

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2240. CONFLICTS OF INTEREST

2241. Research Analysts and Research Reports

(a) Definitions

For purposes of this Rule, the following terms shall be defined as provided.

(1) “Emerging Growth Company” has the same meaning as in Section 3(a)(80) of the Exchange Act.

(2) “Equity security” has the same meaning as defined in Section 3(a)(11) of the Exchange Act.

(3) “Independent third-party research report” means a third-party research report, in respect of which the person producing the report:

(A) has no affiliation or business or contractual relationship with the distributing member or that member’s affiliates that is reasonably likely to inform the content of its research reports; and

(B) makes content determinations without any input from the distributing member or that member’s affiliates.

(4) “Investment banking department” means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(5) “Investment banking services” include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

(6) “Member of a research analyst’s household” means any individual whose principal residence is the same as the research analyst’s principal residence. This term 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.

(7) “Public appearance” means any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons or before one or more representatives of the media, a radio, television or print media interview, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security. This term does not include a password protected Webcast, conference call or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required

applicable disclosures, and that the research analyst appearing at the event corrects and updates during the event any disclosures in the research report that are inaccurate, misleading or no longer applicable.

(8) “Research analyst” means an associated person who is primarily responsible for, and any associated person who reports directly or indirectly to a research analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of “research analyst.”

(9) “Research analyst account” means any account in which a research analyst or member of the research analyst’s household has a financial interest, or over which such analyst has discretion or control. This term shall not include an investment company registered under the Investment Company Act over which the research analyst or a member of the research analyst’s household has discretion or control, provided that the research analyst or member of a research analyst’s household has no financial interest in such investment company, other than a performance or management fee. The term also shall not include a “blind trust” account that is controlled by a person other than the research analyst or member of the research analyst’s household where neither the research analyst nor a member of the research analyst’s household knows of the account’s investments or investment transactions.

(10) “Research department” means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(11) “Research report” means any written (including electronic) communication that includes an analysis of equity securities of individual companies or industries (other than an open-end registered investment company that is not listed or traded on an exchange) and that provides information reasonably sufficient upon which to base an investment decision. This term does not include:

(A) communications that are limited to the following:

(i) discussions of broad-based indices;

(ii) commentaries on economic, political or market conditions;

(iii) technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price;

(iv) statistical summaries of multiple companies’ financial data, including listings of current ratings;

(v) recommendations regarding increasing or decreasing holdings in particular industries or sectors;

(vi) notices of ratings or price target changes, provided that the member 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 this Rule and that such research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable; or

(B) the following communications, even if they include an analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision:

(i) any communication distributed to fewer than 15 persons;

(ii) 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 account's past performance or the basis for previously made discretionary investment decisions; or

(iii) internal communications that are not given to current or prospective customers; and

(C) communications that constitute statutory prospectuses that are filed as part of a registration statement.

(12) "Subject company" means the company whose equity securities are the subject of a research report or public appearance.

(13) "Third-party research report" means a research report that is produced by a person other than the member.

(b) Identifying and Managing Conflicts of Interest

(1) A member must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to:

(A) the preparation, content and distribution of research reports;

(B) public appearances by research analysts; and

(C) the interaction between research analysts and those outside of the research department, including investment banking and sales and trading department personnel, subject companies and customers.

(2) A member's written policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers. Such policies and procedures must at a minimum:

(A) prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel;

(B) restrict or limit input by investment banking department into research coverage decisions to ensure that research management independently makes all final decisions regarding the research coverage plan;

(C) prohibit persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination;

(D) limit determination of research department budget to senior management, excluding senior management engaged in investment banking services activities;

(E) prohibit compensation based upon specific investment banking services transactions or contributions to a member's investment banking services activities;

(F) require that the compensation of a research analyst who is primarily responsible for preparation of the substance of a research report be reviewed and approved at least annually by a committee that reports to a member's board of directors, or if the member has no board of directors, a senior executive officer of the member. This committee may not have representation from the member's investment banking department and must consider the following factors when reviewing a research analyst's compensation, if applicable:

(i) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(ii) the correlation between the research analyst's recommendations and the performance of the recommended securities; and

(iii) the overall ratings received from clients, sales force and peers independent of the member's investment banking department, and other independent ratings services.

The committee must document the basis upon which each such research analyst's compensation was established;

(G) establish information barriers or other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision;

(H) prohibit direct or indirect retaliation or threat of retaliation against research analysts employed by the member or its affiliates by persons engaged in investment banking services activities or other employees as the result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective business interests;

(I) define periods during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer:

(i) of a minimum of 10 days following the date of an initial public offering if the member has participated as an underwriter or dealer in the initial public offering; or

(ii) of a minimum of three days following the date of a secondary offering if the member has acted as a manager or co-manager of that offering.

This subparagraph (I) shall not apply to the publication or distribution of a research report or a public appearance following an initial public offering or secondary offering of the securities of an Emerging Growth Company;

(J) restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst, including:

(i) ensuring that research analyst accounts, supervisors of research analysts and associated persons with the ability to influence the content of research reports do not benefit in their trading from knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report;

(ii) providing that no research analyst account may purchase or sell any security or any option on or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member, and defining financial hardship circumstances, if any (e.g., unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account), in which the member will permit a

research analyst account to trade in a manner inconsistent with such research analyst's most recently published recommendation; and

(iii) prohibiting a research analyst account from purchasing or receiving any security before an issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows;

(K) prohibit explicit or implicit promises of favorable research, a particular research rating or recommendation or specific research content as inducement for the receipt of business or compensation;

(L) restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting:

(i) participation in pitches and other solicitations of investment banking services transactions; and

(ii) participation in road shows and other marketing on behalf of an issuer related to an investment banking services transaction;

(M) prohibit investment banking department personnel from directly or indirectly:

(i) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and

(ii) directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction; and

(N) prohibit prepublication review of a research report by a subject company for purposes other than verification of facts.

(c) Content and Disclosure in Research Reports

(1) A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that:

(A) purported facts in its research reports are based on reliable information; and

(B) any recommendation, rating or price target has a reasonable basis and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.

(2) A member that employs a rating system must clearly define in each research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based. The definition of each rating must be consistent with its plain meaning.

(A) Irrespective of the rating system a member employs, a member must include in each research report that includes a rating the percentage of all securities rated by the member to which the member would assign a “buy,” “hold” or “sell” rating.

(B) A member must disclose in each research report the percentage of subject companies within each of the “buy,” “hold” and “sell” categories for which the member has provided investment banking services within the previous 12 months.

(C) The information required in paragraphs (c)(2)(A) and (B) must be current as of the end of the most recent calendar quarter or the second most recent calendar quarter if the publication date of the research report is less than 15 calendar days after the most recent calendar quarter.

(3) If a research report contains either a rating or price target for a subject company’s security, and the member has assigned a rating or price target to such security for at least one year, the research report must include a line graph of the security’s daily closing prices for the period that the member has assigned any rating or price target or for a three-year period, whichever is shorter. The graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating or price target assigned or changed on those dates; and

(C) be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date of the research report is less than 15 calendar days after the most recent calendar quarter).

(4) A member must disclose in any research report at the time of publication or distribution of the report:

(A) if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;

(B) if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;

(C) if the member or any of its affiliates:

(i) managed or co-managed a public offering of securities for the subject company in the past 12 months;

(ii) received compensation for investment banking services from the subject company in the past 12 months; or

(iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;

(D) if, as of the end of the month immediately preceding the date of publication or distribution of a research report (or the end of the second most recent month if the publication or distribution date is less than 30 calendar days after the end of the most recent month), the member or its affiliates have received from the subject company any compensation for

products or services other than investment banking services in the previous 12 months;

(E) if the subject company is, or over the 12-month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services;

(F) if the member or its affiliates maintain a significant financial interest in the debt or equity securities of the subject company including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;

(G) if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report;

(H) if the research analyst received any compensation from the subject company in the previous 12 months; and

(I) any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.

(5) A member or research analyst will not be required to make a disclosure required by paragraph (c)(4) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(6) The disclosures required by this paragraph (c) must be presented on the front page of research reports or the front page must refer to the page on which the disclosures are found. Electronic research reports may provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by this Rule must be clear, comprehensive and prominent.

(7) A member that distributes a research report covering six or more subject companies (a “compendium report”) may direct the reader in a clear manner as to where the reader may obtain applicable current disclosures required by this paragraph (c). Electronic compendium reports may include a hyperlink directly to the required disclosures. Paper-based compendium reports may provide either a toll free number to call or a postal address to request the required disclosures and may also include a web address where the disclosures can be found.

(d) Disclosure in Public Appearances

(1) A research analyst must disclose in public appearances:

(A) if the research analyst or a member of the research analyst’s household has a financial interest in the debt or equity securities of the subject company (including, without limitation, whether it consists of any

option, right, warrant, future, long or short position), and the nature of such interest;

(B) if the member or its affiliates maintain a significant financial interest in the debt or equity securities of the subject company including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;

(C) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the previous 12 months;

(D) if the research analyst received any compensation from the subject company in the previous 12 months;

(E) if, to the extent the research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of publication or distribution of the research report, was, a client of the member. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst; or

(F) any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance.

(2) A member or research analyst will not be required to make a disclosure required by this paragraph (d) to the extent such disclosure would

reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(3) Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements in this paragraph (d). Such records must be maintained for at least three years from the date of the public appearance.

(e) Disclosure Required by Other Provisions

In addition to the disclosures required by paragraphs (c) and (d), members and research analysts must comply with all applicable disclosure provisions of FINRA Rule 2210 and the federal securities laws.

(f) Termination of Coverage

A member must promptly notify its customers if it intends to terminate coverage of a subject company. Such notice must be made using the member's ordinary means to disseminate research reports on the subject company to its various customers. The notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a member must disclose to its customers its reason for terminating coverage.

(g) Distribution of Member Research Reports

A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of

other customers that the member has previously determined are entitled to receive the research report.

(h) Distribution of Third-Party Research Reports

(1) Subject to paragraph (h)(5), a registered principal or supervisory analyst approved pursuant to Incorporated NYSE Rule 344 must review for compliance with the applicable provisions of paragraph (h) and approve by signature or initial all third-party research reports distributed by a member.

(2) A member may not distribute third-party research if it knows or has reason to know such research is not objective or reliable.

(3) A member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that any third-party research it distributes contains no untrue statement of material fact and is otherwise not false or misleading. For the purposes of this paragraph (h)(3) only, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading information that:

(A) should be known from reading the report; or

(B) is known based on information otherwise possessed by the member.

(4) A member must accompany any third-party research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third-party research provider or the subject company of a third-party research report, including, at a minimum, the disclosures required by paragraphs (c)(4)(C), (c)(4)(F), (c)(4)(G) and (c)(4)(I) of this Rule.

(5) A member shall not be required to review a third-party research report to determine compliance with paragraph (h)(3) if such research report is an independent third-party research report.

(6) A member shall not be considered to have distributed a third-party research report for the purposes of paragraph (h)(4) where the research is an independent third-party research report and is made available by a member (a) upon request; (b) through a member-maintained website; or (c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

(7) A member must ensure that a third-party research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the research report.

(i) Exemption for Members with Limited Investment Banking Activity

The provisions of paragraphs (b)(2)(A), (B), (C), (D), (F) and (G) shall not apply to members that over the previous three years, on average per year, have participated in 10 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; provided, however, that with respect to paragraph (b)(2)(G), such members must establish information barriers or other institutional safeguards to ensure that research analysts are insulated from pressure by persons engaged in investment banking services activities or other persons, including sales and trading department personnel,

who might be biased in their judgment or supervision. For the purposes of this paragraph (i), the term “investment banking services transactions” include the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to paragraphs (b)(2)(A), (B), (C), (D), (F) and (G).

(j) Exemption for Good Cause

Pursuant to the Rule 9600 Series, FINRA may in exceptional and unusual circumstances, conditionally or unconditionally grant an exemption from any requirement of this Rule for good cause shown after taking into account all relevant factors, to the extent such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest.

• • • Supplementary Material: -----

.01 Efforts to Solicit Investment Banking Business

(a) FINRA interprets paragraph (b)(2)(L)(i) to prohibit in pitch materials any information about a member’s research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage. For example, FINRA would consider the publication in a pitch book or related materials of an analyst’s industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. On the other hand, a member would be permitted to include in the pitch materials the fact of coverage and the name of the research analyst because such information alone does not imply favorable coverage.

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

(b) Paragraph (b)(2)(L)(i) shall not prevent a research analyst from attending a pitch meeting in connection with an initial public offering of an Emerging Growth Company that also is attended by investment banking personnel; provided, however, that a research analyst may not engage in otherwise prohibited conduct in such meetings, including efforts to solicit investment banking business.

.02 Joint Due Diligence. FINRA interprets paragraph (b)(1)(C) to prohibit the performance of joint due diligence (i.e., confirming the adequacy of disclosure in offering or other disclosure documents for a transaction) by the research analyst in the presence of investment banking department personnel prior to the selection by the issuer of the underwriters for the investment banking services transaction.

.03 Restrictions on Communications with Customers and Internal Personnel

(a) Consistent with the requirements of paragraph (b)(2)(M) of this Rule, no research analyst may engage in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.

(b) FINRA interprets paragraph (b)(1)(C) of this Rule to require that any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

.04 Disclosure of Non-Investment Banking Services Compensation. A member may satisfy the disclosure requirement in paragraph (c)(4)(D) with respect to receipt of non-investment banking services compensation by an affiliate by implementing policies and procedures reasonably designed to prevent the research analyst and associated persons of the member with the ability to influence the content of research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation. However, a member must disclose receipt of non-investment banking services compensation by its affiliates from the subject company in the past 12 months when the research analyst or an associated person with the ability to influence the content of a research report has actual knowledge that an affiliate received such compensation during that time period.

.05 Submission of Sections of a Draft Research Reports for Factual Review.

Consistent with the requirements of paragraphs (b)(2)(A) and (b)(2)(N), sections of a draft research report may be provided to non-investment banking personnel or to the subject company for factual review so long as:

(a) the sections of the report submitted do not contain the research summary, the research rating or the price target;

(b) a complete draft of the report is provided to legal or compliance personnel before sections of the report are submitted to non-investment banking personnel or the subject company; and

(c) if, after submitting sections of the report to non-investment banking personnel or the subject company, the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization

from, legal or compliance personnel for the change. The member must retain copies of any draft and the final version of such report for three years after publication.

.06 Beneficial Ownership of Equity Securities. With respect to paragraphs (c)(4)(F) and (d)(1)(B), beneficial ownership of any class of common equity securities shall be computed in accordance with the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Exchange Act.

.07 Distribution of Member Research Products. With respect to paragraph (g), a member may provide different research products and services to different classes of customers. For example, a member may offer one research product for those with a long-term investment horizon (“investor research”) and a different research product for those customers with a short-term investment horizon (“trading research”). These products may lead to different recommendations or ratings, provided that each is consistent with the meaning of the member’s ratings system for each respective product. However, a member may not differentiate a research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member label a research product with substantially the same content as a different product as a means to allow certain customers to trade in advance of other customers. In addition, a member that provides different research products and services for different customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain

different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research.

.08 Ability to Influence the Content of a Research Report. For the purposes of this Rule, an associated person with the ability to influence the content of a research report is an associated person who, in the ordinary course of that person's duties, has the authority to review the research report and change that research report prior to publication or distribution.

.09 Obligations of Persons Associated with a Member. Consistent with Rule 0140, persons associated with a member must comply with such member's written policies and procedures as established pursuant to this Rule 2241. Failure of an associated person to comply with such policies and procedures shall constitute a violation of this Rule. In addition, consistent with Rule 0140, it shall be a violation of this Rule for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by this Rule or related Supplementary Material.

.10 Divesting Research Analyst Holdings. With respect to paragraph (b)(2)(J)(ii), FINRA shall not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe; provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.

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9600. PROCEDURES FOR EXEMPTIONS

9610. Application

(a) Where to File

A member seeking exemptive relief as permitted under NASD Rules 1021, 1050, 1070, 2340, or 3150, or Rules 2114, 2210, 2241, 2310, 2359, 2360, 3170, 4210, 4311, 4320, 4360, 5110, 5121, 5122, 5123, 5130, 5131, 6183, 6625, 6731, 7470, 8211, 8213, 11870, or 11900, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of FINRA.

(b) through (c) No Change.

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Text of NASD Rule and Incorporated NYSE Rules to Remain in the Transitional Rulebook

NASD Rule

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1050. Registration of Research Analysts

(a) All persons associated with a member who are to function as research analysts shall be registered with [NASD]FINRA. Before registration as a Research Analyst can become effective, an applicant shall:

- (1) be registered pursuant to NASD Rule 1032 as a General Securities Representative; and

(2) pass a Qualification Examination for Research Analysts as specified by the Board of Governors.

(b) For the purposes of this Rule 1050, “research analyst” shall mean an associated person whose primary job function is to provide investment research and who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.

(c) Upon written request pursuant to the FINRA Rule 9600 Series, [NASD]FINRA will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has [passed]:

(1) passed Levels I and II of the Chartered Financial Analyst (“CFA”) Examination; or

(2) [if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e),] passed Levels I and II of the Chartered Market Technician (“CMT”) Examination, if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e); and

(3) [has] either functioned as a research analyst continuously since having passed the Level II CFA or CMT examination or applied for registration as a research analyst within two years of having passed the Level II CFA or CMT examination.

(d) An applicant who has been granted an exemption pursuant to paragraph (c) still must become registered as a General Securities Representative and then complete the regulatory portion of the Research Analyst Qualification Examination (Series 87) before that applicant can be registered as a Research Analyst.

(e) For the purposes of paragraph (c)(2), a “technical research report” shall mean a research report, as that term is defined in FINRA Rule [2711]2241(a)(8)], that is based solely on stock price movement and trading volume and not on [the]a subject company’s financial information, business prospects, contact with a subject company’s management, or the valuation of a subject company’s securities.

(f) The requirements of paragraph (a) shall not apply to an associated person who:

- (1) is an employee of a non-member foreign affiliate of a member (“foreign research analyst”),
- (2) resides outside the United States, and
- (3) contributes, partially or entirely, to the preparation of globally [-] branded or foreign affiliate research reports but does not contribute to the preparation of a member’s research, including a mixed-team report, that is not globally [-]branded.

Provided that the following conditions are satisfied:

(A) A member that publishes or otherwise distributes globally[-]branded research reports partially or entirely prepared by a foreign research analyst must subject such research to pre-use review and approval by a registered principal in accordance with NASD Rule 1022(a)(5) or a supervisory analyst pursuant to NYSE Rule 344.11. In addition, the member must ensure that such research reports comply with [NASD] FINRA Rule [2711]2241, as applicable.

(B) In publishing or otherwise distributing globally[-]branded research reports partially or entirely prepared by a foreign research analyst, a member must prominently disclose:

- (i) each affiliate contributing to the research report;
- (ii) the names of the foreign research analysts employed by each contributing affiliate;
- (iii) that such research analysts are not registered/qualified as research analysts with FINRA[with the NYSE and/or NASD]; and
- (iv) that such research analysts may not be associated persons of the member and therefore may not be subject to FINRA Rule [2711]2241 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(C) The disclosures required by paragraph (f)(3)(B) of this Rule must be presented on the front page of the research report or the front

page must refer to the page on which the disclosures can be found. In electronic research reports, a member may hyperlink to the disclosures. References and disclosures must be clear, comprehensive and prominent.

(D) Members must establish and maintain records that identify those individuals who have availed themselves of this exemption, the basis for such exemption, and evidence of compliance with the conditions of the exemption. Failure to establish and maintain such records shall create an inference of a violation of Rule 1050. Members must also establish and maintain records that evidence compliance with the applicable content, disclosure and supervision provisions of FINRA Rule 2241[2711]. Members must maintain these records in accordance with the supervisory requirements of NASD Rule 3010, and in addition to such requirement, the failure to establish and maintain such records shall create an inference of a violation of the applicable content, disclosure and supervision provisions of FINRA Rule 2241[2711].

(E) Nothing in paragraph (f) of this Rule shall affect the obligation of any person or broker-dealer, including a foreign broker-dealer, to comply with the applicable provisions of the federal securities laws, rules and regulations and any self-regulatory organization rules.

(F) The fact that a foreign research analyst avails himself of the exemption in paragraph (f) shall not be probative of whether that individual is an associated person of the member for other purposes, including whether the foreign research analyst is subject to the FINRA Rule 2241[2711] restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(G) A member that distributes non-member foreign affiliate research reports that are clearly and prominently labeled as such must comply with the third-party research report requirements in FINRA Rule [2711]2241(h)[(13)].

(H) For the purposes of the exemption in paragraph (f), the terms “affiliate,” “globally[-]branded research report” and “mixed-team research report” shall have the following meanings:

(i) “Affiliate” shall mean a person that directly or indirectly controls, is controlled by, or is under common control with, a member.

(ii) “Globally[-]branded research report” refers to the use of a single marketing identity that encompasses the member and one or more of its affiliates.

(iii) "Mixed-team research report" refers to any member research report that is not globally[-]branded and includes a contribution by a research analyst who is not an associated person of the member.

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Incorporated NYSE Rules

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Rule 344. Research Analysts and Supervisory Analysts

Research analysts and supervisory analysts must be registered with, qualified by, and approved by the Exchange.

• • • Supplementary Material: -----

.10 For purposes of this Rule, the term "research analyst" includes a member, allied member, associated person or employee whose primary job function is to provide investment research and who is primarily responsible for the preparation of the substance of a research report and/or whose name appears on such report. Such research analysts must pass a qualification examination acceptable to the Exchange.

.11 For purposes of this Rule, the term "supervisory analyst" includes a member, allied member, or employee who is responsible for preparing or approving research reports under Rule 472(a)(2). In order to show evidence of acceptability to the Exchange as a supervisory analyst, a member, allied member, or employee may do one of the following:

(1) Present evidence of appropriate experience and pass an Exchange Supervisory Analyst Examination (Series 16).

(2) Present evidence of appropriate experience and successful completion of a specified level of the Chartered Financial Analysts Examination prescribed by the Exchange and pass only that portion of the Exchange Supervisory Analyst Examination (Series 16) dealing with Exchange rules on research standards and related matters.

The Exchange publishes a Study Outline for the Research Analyst Examination and the Supervisory Analyst Examination (Series 16).

.12 For purposes of this Rule, the term "associated person" is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member or member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.

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Rule 472. Communications With The Public

(a) Approval of Communications and Research Reports

(1) Reserved.

(2) Research reports must be approved, in advance, by a supervisory analyst acceptable to the Exchange under the provisions of Rule 344. Where a supervisory analyst does not have technical expertise in a particular product area, the basic analysis contained in such report may be co-approved by a product specialist designated by the organization. In the event that the member organization has no principal or employee qualified with the Exchange to approve such material, it must be approved by a qualified supervisory analyst in another member organization by arrangement between the two member organizations.

[(b) Investment Banking, Research Department and Subject Company Relationships and Communications]

[(1) Research analysts may not be subject to the supervision, or control, of any employee of the member organization's investment banking department and personnel engaged in investment banking activities may not have any influence or control over the compensatory evaluation of a research analyst.]

[(2) Research reports may not be subject to review or approval prior to publication by Investment Banking personnel or any other employee of the member organization who is not directly responsible for investment research ("non-research personnel") other than Legal or Compliance personnel.]

[(3) Non-research personnel may review research reports prior to publication only to verify the factual accuracy of information in the research report or to identify any potential conflicts of interest that may exist, provided that:]

[(i) any written communication concerning the content of research reports between non-research personnel and Research personnel must be made either through Legal or Compliance personnel or in a transmission copied to Legal or Compliance personnel; and]

[(ii) any oral communication concerning the content of research reports between non-research personnel and Research personnel must be documented and made either with Legal or Compliance personnel acting as intermediary or in a conversation conducted in the presence of Legal or Compliance personnel.]

[(4) A member organization may not submit a research report to the subject company prior to publication, except for the review of sections of a draft of the research report solely to verify facts. Members organizations may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.]

[(i) Prior to submitting any sections of the research report to the subject company, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.]

[(ii) If after submission to the subject company, the Research Department intends to change the proposed rating or price target, the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.]

[(iii) The member organization may not notify a subject company that a rating will be changed until after the close of trading in the principal market of the subject company one business day prior to the announcement of the change.]

[(5) A research analyst is prohibited from participating in efforts to solicit investment banking business. This prohibition includes, but is not limited to, participating in meetings to solicit investment banking business (e.g., "pitch" meetings) of prospective investment banking clients, or having other

communications with companies for the purpose of soliciting investment banking business. This prohibition shall not apply to any communication between the research analyst, company, and/or nonresearch personnel, the sole purpose of which is due diligence. This paragraph shall not prevent a research analyst from attending a pitch meeting in connection with an initial public offering of an Emerging Growth Company that is also attended by investment banking personnel; provided, however, that a research analyst may not engage in otherwise prohibited conduct in such meetings, including efforts to otherwise solicit investment banking business.]

[(6) (i) A research analyst is prohibited from directly or indirectly:]

[(a) participating in a road show related to an investment banking services transaction; and]

[(b) engaging in any communication with a current or prospective customer(s) in the presence of investment banking department personnel or company management about an investment banking services transaction.]

[(ii) Investment banking department personnel are prohibited from directly or indirectly:]

[(a) directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction; and]

[(b) directing a research analyst to engage in any communication with a current or prospective customer(s) about an investment banking services transaction.]

[(iii) Research analyst written and oral communications relating to an investment banking services transaction, with a current or prospective customer(s), or with internal personnel, must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.]

[(c) Written Procedures]

[Each member organization must establish written procedures reasonably designed to ensure that allied members, member organizations and their employees are in compliance with this Rule (see Rule 351(f) and Rule 472(h)(2) for attestations to the Exchange regarding compliance).]

[(d) Retention of Communications]

[Communications with the public prepared or issued by a member organization must be retained in accordance with Rule 440 ("Books and Records"). The names of the persons who prepared and who reviewed and approved the material must be ascertainable from the retained records and the records retained must be readily available to the Exchange, upon request.]

[(e) Restrictions on Trading Securities by Associated Persons]

[(1) No research analyst or household member may purchase or receive an issuer's securities prior to its initial public offering (e.g., so-called pre-IPO shares), if the issuer is principally engaged in the same types of business as

companies (or in the same industry classification) which the research analyst usually covers in research reports.]

[(2) No research analyst or household member may trade in any subject company's securities or derivatives of such securities that the research analyst follows for a period of thirty (30) calendar days prior to and five (5) calendar days after the member organization's publication of research reports concerning such security or a change in rating or price target of a subject company's securities.]

[(3) No research analyst or household member may effect trades in a manner inconsistent with the research analyst's most current recommendations (i.e., sell securities while maintaining a "buy" or "hold" recommendation, buy securities while maintaining a "sell" recommendation, or effecting a "short sale" in a security while maintaining a "buy" or "hold" recommendation on such security).]

[(4) Listed below are exceptions to the prohibitions contained in paragraphs (1), (2), and (3) (Each exception granted must be in compliance with policies and procedures adopted by the member organization that are reasonably designed to ensure that transactions effected pursuant to these exceptions do not create a conflict of interest between the professional responsibilities and the personal trading activities of the research analyst and/or his or her household member.):]

[(i) transactions by research analysts and/or household members that have been pre-approved in writing by the Legal or Compliance

Department that are made due to an unanticipated significant change in their personal financial circumstances;]

[(ii) a member organization may permit the publication of research reports or permit a change to the rating or price target on a subject company, regardless of whether a research analyst and/or household members traded the subject company's securities or derivatives of such securities, within the thirty (30) calendar day period described in paragraph (e)(2), when the publication of such research reports, or change in such rating or price target is attributable to some significant news or events regarding the subject company, provided that the publication of such research reports, or change in rating or price target on such subject company has been pre-approved in writing by the Legal or Compliance Department;]

[(iii) sale transactions by a research analyst, who is new to the member organization, and/or his or her household members within thirty (30) calendar days of such research analyst's employment with the member organization when such research analyst and/or household members had previously purchased such security or derivatives of such security prior to the research analyst's employment with the member organization;]

[(iv) sale transactions by a research analyst and/or household member within thirty (30) calendar days from the date of the member organization's publication of research reports or changes to the rating or

price target on a subject company when such research analyst and/or household members had previously purchased the subject company's securities or derivatives of such securities prior to initiation of coverage of the subject company by the research analyst;]

[(v) transactions in accounts not controlled by the research analyst and for investment funds in which a research analyst or household member has no investment discretion or control, provided the interest of the research analyst or household member in the assets of the fund does not exceed 1% of the fund's assets, and the fund does not invest more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies (or in the same industry classification) which the research analyst usually covers in research reports. If an investment fund distributes securities in kind to a research analyst before the issuer's initial public offering, the research analyst must either divest those securities immediately or refrain from participating in the preparation of research reports concerning that issuer;]

[(vi) transactions in a registered diversified investment company as defined under Section 5(b)(1) of the Investment Company Act of 1940.]

[(5) No person who supervises research analysts (e.g., Director of Research), a Supervisory Analyst, or a member of a committee, who has direct influence and/or control with respect to (1) preparing the substance of research reports, or (2) establishing or changing a rating or price target of a subject company's equity securities, may effect trades in securities of companies that are

the subject of such research reports, or ratings or price target changes, without the prior approval of the Legal or Compliance personnel of the member organization.]

[(6) Members organizations must maintain written records for each transaction and the justification for permitting such transactions for three years following the date the transactions were made pursuant to the exceptions provided for in Rule 472(e)(4)(i)–(iv), and (5).]

[(f) Restrictions on Member's or Member Organization's Issuance of Research Reports and Participation in Public Appearances]

[(1) A member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member organization acted as manager or co-manager of an initial public offering within forty (40) calendar days following the offering date.]

[(2) A member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member organization acted as manager or co-manager of a secondary offering within ten (10) calendar days following the offering date. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.]

[(3) No member organization that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering may publish or otherwise distribute a research report regarding that issuer and a research analyst may not recommend or offer an opinion on that issuer's securities in a public appearance for twenty-five (25) calendar days following the offering date.]

[(4) No member organization which has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance within fifteen (15) days prior to or after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member organization has entered into with a subject company and its shareholders that restricts or prohibits the sale of the subject company's or its shareholders' securities after the completion of a securities offering. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.]

[(5) A member organization may permit exceptions to the prohibitions in paragraphs (f)(1), (2), and (4) (consistent with other securities laws and rules) for research reports that are published or otherwise distributed or recommendations or opinions on an issuer's securities made in a public appearance due to significant

news or events, provided that such research reports are pre-approved in writing by the member organization's Legal or Compliance personnel.]

[(6) Paragraphs (f)(1), (f)(2), (f)(3) and (f)(4) shall not apply to the publication or distribution of a research report or a public appearance following an initial public offering or secondary offering of the securities of an Emerging Growth Company.]

[(7) If a member organization intends to terminate its research coverage of a subject company, notice of this termination must be made. The member organization must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is impracticable for the member organization to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the employ of the member organization, or where the member organization terminates coverage on the industry or sector). In instances where it is impracticable for the member organization to provide a final recommendation or rating, the member organization must provide the rationale for the decision to terminate coverage.]

[(g) Prohibition of Offering Favorable Research for Business]

[(1) No member organization may directly or indirectly offer a favorable research rating or specific price target, or offer to change a rating or price target,

to a subject company as consideration or inducement for the receipt of business or for compensation.]

[(2) No member organization and no employee of a member organization who is involved with the member organization's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member organization or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report written or public appearance made by the research analyst that may adversely affect the member organization's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member organization's authority to discipline or terminate a research analyst, in accordance with the member organization's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such unfavorable public appearance.]

[(h) Restrictions on Compensation to Research Analysts]

[(1) No member organization may compensate a research analyst for specific investment banking services transactions. A research analyst may not receive an incentive or bonus that is based on a specific investment banking services transaction. However, a member organization is not prohibited from compensating a research analyst based upon such member organization's overall performance (see Rule 472(k)(1)(ii)a.2. for disclosure of such compensation).]

[(2) The compensation of a research analyst primarily responsible for the preparation of the substance of a research report must be reviewed and approved

at least annually by a committee which reports to the Board of Directors or, where the member organization has no Board of Directors, to a senior executive officer of the member organization. Such committee may not include representatives from the member organization's Investment Banking Department. The committee must, among other things, consider the following factors, if applicable, when reviewing such research analyst's compensation:]

[i. The research analyst's individual performance, (e.g., productivity, and quality of research product);]

[ii. The correlation between the research analyst's recommendations and stock price performance;]

[iii. The overall ratings received from clients, sales force, and peers independent of the Investment Banking Department, and other independent rating services.]

[The committee may not consider as a factor in reviewing and approving such research analyst's compensation, his or her contributions to the member organization's investment banking business.]

[The committee must document the basis upon which such research analyst's compensation was established. The annual attestation required by Rule 351(f) must certify that the committee reviewed and approved the compensation for each research analyst primarily responsible for the preparation of the substance of a research report and has documented the basis upon which such compensation was established.]

[(i) Reserved.]

[(j) Reserved.]

[(k) Disclosure]

[(1) Disclosures Required in Research Reports]

**[Disclosure of Member Organization's and Research Analyst's
Ownership of Securities, Receipt of Compensation, and Subject Company
Relationships]**

[The front page of a research report either must include the disclosures required under this Rule or must refer the reader to the page(s) on which each such disclosure is found. Disclosures, and references to disclosures, must be clear, comprehensive, and prominent.]

[(i) A member organization must disclose in research reports:]

[a. if the member organization or its affiliates:]

[1. has managed or co-managed a public offering of securities for the subject company in the past twelve (12) months;]

[2. has received compensation for investment banking services from the subject company in the past twelve (12) months; or]

[3. expects to receive or intends to seek compensation for investment banking services from the subject company in the next three (3) months.]

[b. if the member organization is making a market in the subject company's securities at the time the research report is issued;]

[c. if, as of the last day of the month immediately preceding the date the publication (or the end of the second most recent month if the publication is less than ten (10) calendar days after the end of the most recent month), the member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;]

[d. if, as of the last day of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than thirty (30) calendar days after the end of the most recent month):]

[1. the subject company currently is a client of the member organization or was a client of the member organization during the twelve (12)-month period preceding the date of distribution of the research report (In such instances, the member organization also must disclose the types of services provided to the subject company. For purposes of this paragraph, the types of services provided

to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);]

[2. the member organization received any compensation for products or services other than for investment banking services from the subject company in the past twelve (12) months.]

[e. if a research report contains a price target, the valuation methods used, and any price objectives must have a reasonable basis and include a discussion of risks;]

[f. if a research report contains a rating, the meanings of all ratings used by the member organization in its ratings system (For example, a member organization might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next twelve (12)-month period. Definitions of ratings terms also must be consistent with their plain meaning. Therefore, for example, a "hold" rating should not mean or imply that an investor should sell a security.);]

[g. if a research report contains a rating, the percentage of all securities that the member organization recommends an investor "buy," "hold," or "sell." Within each of the three (3) categories, a member organization must also disclose the

percentage of subject companies that are investment banking services clients of the member organization within the previous twelve (12) months (see Rule 472.70 for further information);]

[h. 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 (1) year, the research report must include a chart that depicts the price of the subject company's stock over time and indicates points at which a member organization assigned or changed a rating or price target. This provision would apply only to securities that have been assigned a rating or a target price for at least one (1) year, and need not extend more than three (3) years prior to the date of the research report. The information in the price chart must 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 fifteen (15) calendar days after the most recent calendar quarter).]

[(ii) A member organization must include the following disclosures in research reports:]

[a. if a research analyst received any compensation:]

[1. from the subject company in the past twelve (12) months;]

[2. that is based upon (among other factors) the member organization's overall investment banking revenues.]

[b. if, to the extent the research analyst or an employee of the member organization with the ability to influence the substance of a research report, knows:]

[1. the subject company currently is a client of the member organization or was a client of the member organization during the twelve (12)-month period preceding the date of distribution of the research report. In such instances, such member organization also must disclose the types of services provided to the subject company (For purposes of paragraph (k)(1) of this Rule, the types of services provided to the subject company may be described as investment banking services, noninvestment banking-securities related services, and non-securities services.). (For purpose of paragraph (k)(1) of this Rule, an employee of a member organization with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.);]

[2. that the member organization or any affiliate thereof, received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months.]

[(iii) A research analyst and a member organization must disclose in research reports:]

[a. if, to the extent the research analyst or member organization has reason to know, an affiliate of the member organization received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months;]

[1. This requirement will be deemed satisfied if such compensation is disclosed in research reports within thirty (30) days after completion of the most recent calendar quarter, provided that the member organization has taken steps reasonably designed to identify such compensation during that calendar quarter.]

[2. The member organization and the research analyst will be presumed not to have reason to know whether an affiliate received compensation for other than investment banking services from the subject company in the past twelve (12) months if the member organization maintains and enforces policies and procedures reasonably

designed to prevent all research analysts and employees of the member organization with the ability to influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning such compensation.]

[3. Paragraph 472(k)(1)(iii)a. shall not apply to any subject company as to which the member organization initiated coverage since the beginning of the current calendar quarter.]

[b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;]

[c. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;]

[d. any other actual, material conflict of interest of the research analyst, or member organization, of which the research analyst knows, or has reason to know, at the time the research report is published or otherwise distributed.]

[When a member organization publishes or otherwise distributes a research report covering six (6) or more subject companies (a "compendium report") for purposes of the disclosures required in paragraph (k)(1) of this Rule, the compendium report may direct the reader in a clear and prominent manner as

to where the reader may obtain applicable current disclosures Electronic compendium reports may include a hyperlink to the required disclosures. Paper-based compendium reports 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.]

[(2) Disclosures Required in Public Appearances]

[Disclosure of Member Organization's and Research Analyst's Ownership of Securities, Receipt of Compensation, and Subject Company Relationships]

[(i) A research analyst must disclose in public appearances:]

[a. if, as of the last day of the month before the appearance (or the end of the second most recent month if the appearance is less than ten (10) calendar days after the end of the most recent month), the member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;]

[b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;]

[c. if, to the extent the research analyst knows or has reason to know:]

[1. the subject company currently is a client of the member organization or was a client of the member organization during the twelve (12)-month period preceding the date of the public appearance by the research analyst. In such instances, the research analyst also must disclose the types of services provided to the subject company (For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);]

[2. the member organization or any affiliate thereof, received any compensation from the subject company in the past twelve (12) months.]

[d. any other actual, material conflict of interest of the research analyst, or member organization, of which the research

analyst knows, or has reason to know, at the time the public appearance is made;]

[e. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;]

[f. if the research analyst received any compensation from the subject company in the past twelve (12) months.]

[(3) Exceptions to the Required Disclosures]

[(i) A member organization or a research analyst will not be required to make a disclosure required by Rule 472(k)(1)(i)a.2. and 3., (k)(1)(i)d.1., (k)(1)(ii)b.1., and (k)(2)(i)c. to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company.]

[(4) Third-Party Research Reports]

[(i) Subject to paragraph (k)(4)(ii) of this Rule, if a member organization distributes or makes available any third-party research report, the member organization must accompany the research report with, or provide a web address that directs the recipient to, the current applicable disclosures, as they pertain to the member organization, required by paragraphs (k)(1)(i)c, (k)(1)(i)a, (k)(1)(i)b and (k)(1)(iii)d of this Rule. Member organizations must establish written supervisory policies and procedures reasonably designed to ensure the completeness and accuracy of all applicable disclosures.]

[(ii) The requirements in paragraph (k)(4)(i) of this Rule shall not apply to independent third-party research reports made available by a member organization to its customers:]

[a. upon request;]

[b. in connection with a solicited order in which a registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security, and the customer requests such independent research; or]

[c. through a member organization-maintained website.]

[(iii) Subject to paragraph (k)(4)(iv) of this Rule, a supervisory analyst, qualified under NYSE Rule 344, or a qualified person, designated pursuant to Rule 342(b)(1), must approve by signature or initial all third-party research reports distributed by a member organization. The approval of third-party research shall be based on a review by the designated supervisory analyst or qualified person to determine that the content of the research report, pursuant to Rule 472(i), contains no untrue statement of material fact or is otherwise not false or misleading. For the purposes of paragraph (k)(4) of this Rule only, a member organization's obligation to review a third-party research report pursuant to Rule 472(i) extends to any untrue statement of material fact or any false or misleading information that:]

[1. should be known from reading the report; or]

[2. is known based on information otherwise possessed by the member organization.]

[(iv) The requirements of paragraph (k)(4)(iii) of this Rule shall not apply to independent third-party research reports distributed or made available by a member organization.]

[(v) For the purposes of this Rule, "third-party research report" shall mean a research report that is produced by a person or entity other than the member organization and "independent third-party research report" shall mean a third-party research report, in respect of which the person or entity producing the report:]

[a. has no affiliation or business or contractual relationship with the distributing member organization or that member organization's affiliates that is reasonably likely to inform the content of its research reports; and]

[b. makes content determinations without any input from the distributing member organization or that member organization's affiliates.]

[(l) Reserved.]

[(m) Small Firm Exception]

[The provisions of Rule 472(b)(1), (2) and (3) do not apply to member organizations that over the three previous years, on average per year, have participated in ten (10) or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those

transactions. For purposes of this paragraph, the term "investment banking services transactions" shall include both debt and equity underwritings but not municipal securities underwritings. Members organizations that qualify for this exemption must maintain records for three (3) years of any communications that, but for this exemption, would be subject to paragraphs (b)(1), (2), and (3) of this Rule.]

[• • • Supplementary Material: -----]

[.10 Definitions]

[(1) Reserved.]

[(2) Research Report]

["Research report" is generally defined as a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and provides information reasonably sufficient upon which to base an investment decision.

This term does not include:]

[(a) communications, that are limited to the following:]

[(1) reports discussing broad-based indices, e.g. 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; or]

[(6) notices of ratings or price target changes, provided that the member organization simultaneously directs the readers of the notice as to where to obtain the most recent research report on the subject company that includes the current applicable disclosures required by this rule and that such research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable;]

[(b) the following communications, 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, solicitations 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 account's past performance or the basis for previously made discretionary investment decisions; or]

[(3) internal communications that are not given to current or prospective customers; and]

[(c) communications that constitute statutory prospectuses that are filed as part of the registration statement.]

[For purposes of approval by a supervisory analyst pursuant to Rule 472(a)(2), the term research report includes, but is not limited to, a report which recommends equity securities, derivatives of such securities, including options, debt and other types of fixed income securities, single stock futures products, and other investment vehicles subject to market risk. This term does not include:]

[(3) Reserved.]

[(4) Reserved.]

[(5) Reserved.]

[(6) "Emerging Growth Company" has the same meaning as defined in Section 3(a)(80) of the Securities Exchange Act of 1934.]

[.20 For purposes of this Rule, "investment banking services" includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transactions), or similar investments; serving as placement agent for the issuer; or acting as a member of a selling group in a securities underwriting.]

[.30 For purposes of this Rule, the term "Investment Banking Department" means any department or division of the member organization, whether or not identified as such, that performs any investment banking services on behalf of the member organization.]

[.40 For purposes of this Rule, the term "research analyst" includes an allied member, associated person or employee of a member organization primarily responsible for, and any person who reports directly or indirectly to such research analyst in connection with, the preparation of the substance of a research report whether or not any such person has

the job title of "research analyst".]

[For purposes of this Rule, the term "household member" means any individual whose principal residence is the same as the research analyst's principal residence. This term 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. Paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v), (k)(1)(iii)b., c., and (k)(2)(i)b. and e. apply to any account in which a research analyst has a financial interest, or over which the research analyst exercises discretion or control, other than an investment company registered under the Investment Company Act of 1940. The trading restrictions applicable to research analysts and household members (i.e., paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v)); do not apply to a "blind trust" account that is controlled by a person other than the research analyst or research analyst's household member where neither the research analyst nor household member knows of the account's investments or investment transactions.]

[.50 For purposes of this Rule, the term "public appearance" includes, without limitation, participation by a research analyst in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before fifteen (15) or more persons or before one or more representatives of the media, radio, television or print media interview, or the writing of a print media article in which such research analyst makes a recommendation or offers an opinion concerning any equity securities. This term does not include a password protected Webcast, conference call or similar event with fifteen (15) or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains

the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading or no longer applicable.]

[.60 For purposes of this Rule, "subject company" is the company whose equity securities are the subject of a research report or a public appearance.]

[.70 For purposes of Rule 472(k)(1)(i)g, a member organization must determine, based on its own ratings system, into which of the three (3) categories each of their securities ratings utilized falls. This information must 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 fifteen (15) calendar days after the most recent calendar quarter) and must reflect the distribution of the most recent ratings that the member organization has issued for all subject companies, within the previous twelve (12) months. For example, a research report might disclose that the member organization has assigned a "buy" rating to 58% of the securities that it follows, a "hold" rating to 15%, and a "sell" rating to 27%.]

[Rule 472(k)(1)(i)g requires member organizations to disclose the percentage of companies that are investment banking services clients for each of the three (3) ratings categories within the previous twelve (12) months. For example, if twenty (20) of the twenty-five (25) companies to which a member organization has assigned a "buy" rating are investment banking clients of the member organization, the member organization would have to disclose that 80% of the companies that received a "buy" rating are its investment banking clients. Such disclosure must be made for the "buy," "hold" and "sell" ratings categories as appropriate.]

[.80 For purposes of this Rule, the term "Legal or Compliance Department" also includes, but is not limited to, any department of the member organization which performs a similar function.]

[.90 Reserved.]

[.100 For purposes of this Rule, the term "initial public offering" refers to the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement.]

[.110 For purposes of this Rule, a secondary offering shall include a registered follow-on offering by an issuer or a registered offering by persons other than the issuer involving the distribution of securities subject to Regulation M of the Securities Exchange Act of 1934.]

[.120 For purposes of this Rule, the term "offering date" refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.]

[.130 For purposes of this Rule, the term associated person is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.]

[.140 For the purpose of this Rule, the term "equity security" has the same meaning as defined in Section 3(a)(11) of the Securities Exchange Act of 1934.]

* * * * *

Text of NASD Rule, Incorporated NYSE Rule, and Incorporated NYSE Rule Interpretation to be Deleted In Their Entirety from the Transitional Rulebook

NASD Rule

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Rule 2711. Research Analysts and Research Reports

Entire text deleted.

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Incorporated NYSE Rule

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Rule 351. Reporting Requirements

Entire text deleted.

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NYSE Rule Interpretation

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Rule 472. Communications With The Public

Entire text deleted.

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