

**MEMO# 21681**

October 1, 2007

# **FINRA Proposes Rule Changes Relating to Research Analysts Conflicts of Interest**

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 57-07  
SEC RULES COMMITTEE No. 74-07 RE: FINRA PROPOSES RULE CHANGES RELATING TO RESEARCH ANALYSTS CONFLICTS OF INTEREST

The Securities and Exchange Commission has published for comment two proposed rule changes filed by FINRA to amend NASD and NYSE rules that address research analyst conflicts of interest. The first proposal would amend current rules regarding a member's disclosure and supervisory review obligations when distributing third-party research. [\[1\]](#) The second proposal would amend an exemption for certain research analysts employed by a member's foreign affiliate who contributes to the preparation of a member's research report. [\[2\]](#) The most significant aspects of the proposals are summarized below.

## **Third Party Research**

In 2002, the SEC approved new NASD Rule 2711 and amendments to NYSE Rules 351 and 472 to implement basic reforms to separate research from investment banking and to provide more extensive disclosure of conflicts of interest in research reports and public appearances. The first proposal would amend NASD Rule 2711 and NYSE Rule 472 to modify a member's disclosure and supervisory review obligations when distributing or making available a research report produced by a third party. Specifically, the proposal would define a "third-party research report" as a research report produced by a person or entity other than a member. The proposal would further create a subcategory of "independent third-party research" [\[3\]](#) and eliminate the current content review requirement when a member distributes or makes available such research, either upon request, through a member-maintained website, or in connection with a solicitation (as described in the proposed rule). The proposal also would amend the existing rules to allow

a member to direct a customer to a web address for the requisite disclosures when a third-party research report does not meet the proposed definition of “independent third-party research.”

## Foreign Affiliate Exemption

The second proposal would amend an exemption to NASD Rule 1050 and NYSE Rule Interpretation 344/02, limiting the application of the research analyst qualifications requirements, to apply to research analysts residing anywhere outside of the United States. In particular, certain of the qualifications requirements for research analysts would not apply to an associated person who (1) is an employee of a non-member foreign affiliate of a member, (2) resides outside of the U.S. 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. Eligibility for the exemption would be conditioned on the member satisfying certain supervisory, disclosure and recordkeeping requirements.

Heather L. Traeger  
Assistant Counsel

### endnotes

[1] SEC Release No. 56480 (September 20, 2007), 72 FR 54698 (September 26, 2007). Comments are due October 17, 2007. The proposal can be found at <http://www.sec.gov/rules/sro/finra/2007/34-56480.pdf>.

[2] SEC Release No. 56481 (September 20, 2007), 72 FR 54700 (September 26, 2007). Comments are due October 17, 2007. The proposal can be found at <http://www.sec.gov/rules/sro/finra/2007/34-56481.pdf>.

[3] The proposal would define “independent third-party research” as that in which the person or entity producing the report: (1) has no affiliation or business or contractual relationship with the distributing member or its affiliates that is reasonably likely to inform the content of its research reports; and (2) makes coverage and content determinations without any input from the distributing member or its affiliates.