

**MEMO# 22240**

February 15, 2008

# **SEC Approves FINRA Proposals Relating to Research Analysts Conflicts of Interest**

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TO: EQUITY MARKETS ADVISORY COMMITTEE No. 7-08  
SEC RULES MEMBERS No. 16-08 RE: SEC APPROVES FINRA PROPOSALS RELATING TO RESEARCH ANALYSTS CONFLICTS OF INTEREST

The Securities and Exchange Commission has approved two proposals filed by FINRA to amend NASD and NYSE rules that address research analyst conflicts of interest. [1] The first proposal amends current rules regarding a member's disclosure and supervisory review obligations when distributing or making available third-party research. [2] The second proposal amends an exemption for certain research analysts employed by a member's foreign affiliate who contribute to the preparation of a member's research report. [3] FINRA will announce the effective date of the proposals in a Regulatory Notice to be published sixty days after the SEC's approval of the proposals. 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 amends 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 defines a “third-party research report” as a research report produced by a person or entity other than a member.

The proposal further creates a subcategory of “independent third-party research.” Such research is defined as that in which the person or entity producing the report: 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 makes content determinations without any input from the distributing member or that member’s affiliates. [4] The proposal also eliminates 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 amended rule).

In addition, the proposal amends 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.” As modified, the proposal will allow members to meet the disclosure review requirement for non-independent or pushed out independent third-party research if the member establishes written supervisory policies and procedures reasonably designed to ensure the completeness and accuracy of all applicable disclosures.

## **Foreign Affiliate Exemption**

The second proposal amends 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 will 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 will be conditioned on the member satisfying certain supervisory, disclosure and recordkeeping requirements.

In response to comments, FINRA modified the disclosure requirements in the proposal. The proposal originally required the requisite disclosures to appear on the front page of the research report. As amended, the proposal requires disclosures be present 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.

**endnotes**

[1] Both proposals were modified in response to concerns raised by commenters.

[2] SEC Release No. 57279 (February 6, 2008), 73 FR 8089 (February 12, 2008). The proposal can be found at <http://www.sec.gov/rules/sro/finra/2008/34-57279.pdf>.

[3] SEC Release No. 57278 (February 6, 2008), 73 FR 8086 (February 12, 2008). The proposal can be found at <http://www.sec.gov/rules/sro/finra/2008/34-57278.pdf>.

[4] In response to comments, FINRA eliminated the prohibition on coverage determinations from the proposed definition. It agreed with commenters that many firms request coverage from independent research providers of particular sectors or market capitalization companies to supplement their own research or offer a second opinion of companies they cover. Thus, FINRA concluded that input into coverage determinations does not necessarily compromise the independence of a third-party research report.