

**MEMO# 14870**

July 3, 2002

## **NASD AND NYSE INTERPRETIVE GUIDANCE ON ANALYST CONFLICT OF INTEREST RULES**

[14870] July 3, 2002 TO: SEC RULES MEMBERS No. 47-02 COMPLIANCE ADVISORY COMMITTEE No. 47-02 INVESTMENT ADVISER MEMBERS No. 26-02 CLOSED-END INVESTMENT COMPANY MEMBERS No. 23-02 RE: NASD AND NYSE INTERPRETIVE GUIDANCE ON ANALYST CONFLICT OF INTEREST RULES As we previously informed you,<sup>1</sup> the Securities and Exchange Commission recently approved proposals by the NASD and the New York Stock Exchange to amend their rules to address research analyst conflicts of interest. The NASD and the NYSE have issued a Joint Memorandum providing interpretive guidance on these rules. The most significant aspects of the Memorandum are summarized below and a copy of the Memorandum is attached. Definition of "Research Analyst" The Memorandum provides clarification on several definitions contained in the rules, including, of most significance to members, the definition of "research analyst." In particular, the Memorandum clarifies that the terms "research analyst" and "associated person" 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."<sup>2</sup> Under the rules, the term "research report" has four components. In particular, a "research report" is (1) a written or electronic communication, (2) that includes an analysis of 1 Memorandum to SEC Rules Members No. 35-02, Compliance Advisory Committee No. 40-02, Closed-End Investment Company Members No. 20-02 and Investment Adviser Members No. 22-02, dated May 13, 2002. 2 For purposes of the NYSE rules, the term "research analyst" as used in the Memorandum refers to any "associated person" as that term is defined in NYSE Rule 472.40. 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." 2 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. In our comment letter to the SEC on the proposed rule changes, the Institute sought clarification on whether the definition of "research report" would include a report or statement, prepared by an investment adviser discussing the performance of a

mutual fund, that includes a description of specific portfolio holdings. Although the Memorandum does not directly address this issue, it states that the issue of whether a particular communication constitutes a “research report” for purposes of the rules will turn on the individual facts and circumstances surrounding that communication. Member Ownership of Subject Company Securities The NASD and NYSE rules 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 one percent or more of any class of common equity securities of the subject company. In our comment letter on the proposed rule changes, the Institute sought clarification that the disclosure requirements relating to a member organization’s ownership of securities would not include the holdings of fiduciary accounts (e.g., mutual funds) managed by a member firm or its affiliate. The Memorandum notes that several commenters requested guidance as to the scope of “affiliate” ownership, including whether it encompasses mutual funds managed by an affiliated investment adviser, ownership by member employees, and trust accounts managed by an affiliated bank. In response, the Memorandum states that the rules refer to Section 13(d) of the Exchange Act for the standards to determine what constitutes beneficial ownership and, therefore, 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. Ari Burstein Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 14870, or call the ICI Library at (202) 326-8304 and request the attachment for memo 14870. Attachment (in .pdf format)

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