

**MEMO# 14720**

May 13, 2002

## **SEC APPROVES NASDR AND NYSE PROPOSED RULE CHANGES RELATING TO RESEARCH ANALYST CONFLICTS OF INTEREST**

[14720] May 13, 2002 TO: SEC RULES MEMBERS No. 35-02 COMPLIANCE ADVISORY COMMITTEE No. 40-02 CLOSED-END INVESTMENT COMPANY MEMBERS No. 20-02 INVESTMENT ADVISER MEMBERS No. 22-02 RE: SEC APPROVES NASDR AND NYSE PROPOSED RULE CHANGES RELATING TO RESEARCH ANALYST CONFLICTS OF INTEREST The Securities and Exchange Commission has issued an order approving proposed rule changes filed by NASD Regulation and the New York Stock Exchange<sup>1</sup> to amend their rules to address research analyst conflicts of interest. In particular, the rules: limit the relationships and communications between a firm's investment banking department and its research department; place various restrictions on, and impose certain disclosure requirements with respect to, analyst and firm compensation arrangements; take measures to prevent promises of favorable research; place various restrictions on an analyst's personal trading; and require disclosures about the ownership of securities by the firm and the analyst. The Institute filed a comment letter with the SEC on the proposed rule changes. In that letter, the Institute stated that it was pleased that, due to the definition proposed for the term "research analyst," most portfolio managers would not be subject to the proposed rules' requirements. The Institute's letter also sought clarification that: (1) the definition of "research report" would not include a report or statement prepared by an investment adviser which discusses the performance of a mutual fund and that includes a description of specific portfolio holdings, and (2) 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 Release does not specifically address the requested clarifications. It does, however, note that there was substantial concern among commenters regarding several aspects of the definition of "research report," specifically, inconsistencies between the NASD's and NYSE's definitions and the scope of the proposed definitions. In response to these comments, the 1 Securities Exchange Act Release No. 45908 (May 10, 2002) ("Release"). The new rules will be phased in over a staggered period, depending on the specific rule requirement. 2 NASD and NYSE amended their proposal to harmonize the definitions of "research report" under both rules.<sup>2</sup> The Release also notes that commenters' concerns included whether the definition of "research report" would include reports by investment advisers not principally responsible for the preparation of research and whether the proposals' disclosure requirements would apply to research reports that are distributed by member firms to their customers, but have been prepared by non-member organizations, including investment

advisers. The Release states that NASDR and the NYSE acknowledge that the distribution of research reports prepared by non- member firms raises complex issues that will vary depending on the type of report, the entity that created the report, and the member's participation in its production or distribution. NASDR and the NYSE intend to review the application of the rules to these reports on a case- by-case basis. According to the Release, however, generally, where a member firm is distributing in the United States research of its affiliate, the member firm should disclose those applicable conflicts required by the rules that relate to the member but not those relating to the non-member affiliate or its employees. Ari Burstein Associate Counsel Attachment 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 14720, or call the ICI Library at (202) 326-8304 and request the attachment for memo 14720. Attachment (in .pdf format) 2 The final rules define "research report" as "a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and which provides information reasonably sufficient upon which to base an investment decision and includes a recommendation."

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