

MEMO# 14545

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NASD AND NYSE PROPOSED RULE CHANGES RELATING TO RESEARCH ANALYST CONFLICTS OF INTEREST

[14545] March 18, 2002 TO: SEC RULES COMMITTEE No. 21-02 COMPLIANCE ADVISORY COMMITTEE No. 22-02 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 10-02 RE: NASD AND NYSE PROPOSED RULE CHANGES RELATING TO RESEARCH ANALYST CONFLICTS OF INTEREST The Securities and Exchange Commission has published for comment proposed rule changes filed by the NASD and the New York Stock Exchange¹ to address research analyst conflicts of interest. The most significant aspects of the proposals are summarized below. Comments on the proposed rule changes are due to the SEC no later than April 4, 2002. We have scheduled a conference call for Thursday, March 21 at 3:00 p.m. (Eastern) to discuss the proposed rule changes and the Institute's comment letter on the proposals. If you would like to participate on the conference call, the dial in number will be 888-390-3404 and the pass code will be "Analyst Disclosure/Burstein." In addition, if you plan to participate on the conference call, please contact Monica Carter-Johnson by phone at 202-326-5823, by fax at 202-326-5827 or by e-mail at mcarter@ici.org. In general, the NASD's proposed rule change would minimize the influence that a member's investment banking department has over its research department and would restrict analysts' personal trading of securities. The proposed rule change also would require disclosure of financial interests held by a member firm, the analyst and his or her family members, and any other material conflict of interest associated with a recommendation of a security. Finally, the proposed rule change would require firms to clarify the meanings of their research ratings and provide historical price and ratings distribution data in research reports to better enable investors to evaluate and compare the quality of research. In contrast to the NASD Notice to Members² requesting comment on a proposed amendment to NASD Rule 2210, which specifically would have applied to portfolio managers of investment companies and other discretionary accounts in those instances where those managers are also associated persons of an NASD member, the current proposal does not appear to include portfolio managers. 1 Securities Exchange Act Release No. 45526 (March 8, 2002), 67 FR 11526 (March 14, 2002) ("Release"). 2 NASD Notice to Members 01-45 (July 2001). 2 In particular, the NASD proposed rule change defines "research analyst" as an "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.'" "Research report" is defined as "a written or electronic communication that the member has distributed or will distribute with reasonable regularity to its customers or the general public, which presents an opinion or recommendation concerning an equity security." The Release specifically states that because most mutual fund portfolio managers are not

principally responsible for the preparation of “research reports” as defined by the NASD proposed rule change, a mutual fund portfolio manager generally would not be deemed to be a “research analyst,” even if the portfolio manager is an associated person of a member firm and discusses the mutual fund’s portfolio holdings in a television interview. The NASD requests comments on whether the definition of “research analyst” would have any regulatory gaps; whether it would impose any unnecessary burdens on members, particularly by including any associated person who reports to a research analyst; and whether the definition of “research report” properly excludes those communications that do not present the types of concerns that the proposed rule change is designed to address. Similar to the NASD’s proposed rule change, the NYSE’s proposal would place prohibitions and/or restrictions on a member’s investment banking and research departments and would impose additional disclosure requirements on members, member organizations, and associated persons preparing research reports and making public appearances. The proposed rule change also would require members and member organizations to submit to the Exchange, on an annual basis, a written attestation that the member or member organization has established and implemented written procedures reasonably designed to comply with the provisions of the NYSE rules. Ari Burstein Associate Counsel Attachment Attachment (in .pdf format)

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