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Research Regulation Panel Discussion

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Agenda

- Current Regulatory Landscape
 - U.K.
 - U.S.
- Rules 472 and 2711 Proposed Changes
 - Discussion of Key Issues and Comments
- Other Developments
 - Supervision of Third-Party Research
 - Non-U.S. Research Analyst Proposal
 - Global Settlement Status Update
- Questions

U.K. Regulatory Landscape

- Principles-Based Regulation
 - Outcome, not process
 - Flexibility for firms
 - Effective and efficient regulation

U.K. Regulatory Landscape

- The 11 Principles for Businesses
 - Principle 1 - Integrity
 - Principle 2 - Skill, care and diligence
 - Principle 3 - Management and control
 - Principle 4 - Financial prudence
 - Principle 5 - Market conduct
 - Principle 6 - Customers' interests
 - Principle 7 - Communications with clients
 - Principle 8 - Conflicts of interest
 - Principle 9 - Customers: relationships of trust
 - Principle 10 - Clients' assets
 - Principle 11 - Relations with regulators

U.K. Regulatory Landscape

- Conflicts of Interest
 - MiFID provisions on conflicts represent a shift to structure and process
 - Written policy for identification and management of conflicts of interest
 - Less reliance on disclosure

U.K. Regulatory Landscape

- Investment Research
 - MiFID emphasis on labelling to reflect production circumstances
 - Parallel with global settlement
 - Market Abuse Directive – fair presentation and disclosure

U.K. Regulatory Landscape

- Principles-based regulation in practice - investment research
 - High-level rules
 - All reasonable steps
 - Appropriate and proportionate

U.S. Regulatory Landscape

- U.S. Regulatory Landscape
 - FINRA Now in Operation
 - Single Rulebook on the Horizon
 - Proposed Changes Pending to NASD Rule 2711 and NYSE Rule 472
 - FINRA Proposal Regarding Third-Party Research
 - FINRA Proposal Regarding Foreign Research Analysts
 - Global Settlement Status Update

Rules 472 and 2711 Proposed Changes

- Research Report – Current Definition
 - A “research report” means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.
 - Exceptions:
 - Reports discussing broad-based indices that don’t recommend or rate individual securities
 - Reports on economic, market or political conditions that don’t recommend or rate individual securities
 - Technical analysis of a sector, index or industry
 - Reports distributed to fewer than 15 investors
 - Internal communications

Rules 472 and 2711 Proposed Changes (cont'd)

- Exclusions from the definition of “Research Report”
 - Open-end registered investment companies
 - Public direct participation programs
- Exception to registration and qualification requirements for non-research personnel who produce “research reports”
- Prohibition on retaliation vs. analysts expanded to all employees, not just bankers

Rules 472 and 2711 Proposed Changes (cont'd)

- Prohibition on pre-publication review of research reports by investment banking and all non-research personnel but L&C
- Alternate Disclosure Method – Web Publication of Conflict Disclosures – with prominent warning on cover that the Firm and/or research analyst has a conflict of interest
- Prohibition on analysts engaging in communications about a transaction with customer in the presence of banking personnel or company management expanded to include communications with sales personnel.

Rules 472 and 2711 Proposed Changes (cont'd)

- IPO quiet periods shortened 40 days to 25 days
- Elimination of quiet periods following secondary offerings
- Exemption from personal trading restrictions when Firms who choose to prohibit analysts from owning shares of companies they cover adopt policies that permit analysts to divest their holdings controlled manner.

Rules 472/2711 - Proposed Changes that Differ

- Quiet Periods – Lock-Up Agreements
 - NASD replaces quiet period with certification requirement
 - NYSE reduces quiet period from 15 to 5 days (before or after the expiration, waiver or termination)
- Significant Event Exception

Rules 472/2711 - Proposed Changes that Differ (cont'd)

- Other Changes related to Personal Trading by Research Analysts
 - NASD eliminates 20% asset diversification threshold and permits analysts to invest in any fund so long as neither the analyst or household member is made aware of the funds' holdings or transactions other than through periodic reports and sales materials
 - NYSE believes 20% threshold must be retained

FINRA Proposal on Third-Party Research Reports

- Content review requirement would be eliminated for “independent third-party research reports” distributed by member firms
- Exception from disclosure review requirement for certain independent third-party research reports.
- Member firms would be allowed to direct a customer to a web address where the applicable third-party disclosures could be found instead of including them in the report itself.

FINRA Proposal on Third-Party Research Reports (cont'd)

- “Independent Third-Party Research Report.” A third-party research report, in respect of 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 coverage and content determinations without any input from the distributing member or that member’s affiliates.
- “Third-Party Research Report.” A research report that is produced by a person or entity other than a member firm.

FINRA Proposal on Foreign Research Analysts – Proposed Exemption

- Registration requirements would not apply to an associated person who:
 - is an employee of a nonmember foreign affiliate of a member firm (“foreign research analyst”);
 - resides outside the United States; and
 - contributes 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.

FINRA Proposal on Foreign Research Analysts – Proposed Exemption (cont'd)

- Additional Conditions to Proposed Exemption
 - Supervision. Research reports would be subject to pre-use review and approval by a registered principal or a supervisory analyst
 - Disclosure. Member firms would be required to include prominent required disclosures on the front page of research reports partially or entirely prepared by a foreign research analyst
 - Recordkeeping. Member firms would be required to establish and maintain records that identify those individuals who have availed themselves of the exemption from registration for foreign research analysts, the basis for such exemption, and evidence of compliance with the conditions of the exemption.

Questions