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Regulatory Requirements Governing Research Reports and Research Analysts

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September 28, 2007

REGULATORY REQUIREMENTS GOVERNING RESEARCH REPORTS AND RESEARCH ANALYSTS*

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I. KEY DEFINITIONS²

A. Research Report (NASD Rule 2711(a)(9), NYSE Rule 472.10(2); see also Rule 500 of Regulation AC).

1. A Research Report is any written or electronic communication that includes an analysis of *equity securities* of individual companies or industries and provides information reasonably sufficient upon which to base an investment decision.³

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² On July 30, 2007, the member regulation functions of NASD, Inc. (“NASD”) and the New York Stock Exchange LLC (“NYSE”) were consolidated into a single self-regulatory organization, the Financial Industry Regulatory Authority (“FINRA”). The FINRA rulebook currently consists of NASD Rules and certain NYSE Rules that FINRA has incorporated, which include NYSE Rule 472 relating to research reports and research analysts, as well as NYSE Rules 342 (Offices—Approval, Supervision and Control), 344 (Research Analysts and Supervisory Analysts), and 351 (Reporting Requirements). The NYSE Rules incorporated by FINRA apply to those members of FINRA that are also members of NYSE on or after July 30, 2007.

Prior to the formation of FINRA, NASD and NYSE submitted proposed rule changes to the Securities and Exchange Commission (“SEC”) to amend certain aspects of their research requirements under NASD Rule 2711 and NYSE Rule 472. See Securities Exchange Act Release No. 55072 (January 9, 2007), 72 FR 2058 (January 17, 2007). This outline includes applicable references to those proposed changes to NASD Rule 2711 and NYSE Rule 472. In addition, this outline includes references to other proposals filed by FINRA to amend certain of the requirements described herein.

³ NASD Rule 2711 and NYSE Rule 472, as well as Regulation AC, do not apply to fixed income research, but the Bond Market Association (now the Securities Industry and Financial Markets Association) has issued *Guiding Principles to Promote the Integrity of Fixed Income Research* (“BMA Guidelines”) to address research issues specific to the fixed income market. Although the BMA Guidelines are not the equivalent of sanctionable rules, NASD and NYSE have indicated that they review member firms’ compliance with the BMA Guidelines to help inform consideration of whether they should adopt their own rules governing fixed income research. See NASD Notice to Members 06-36; NYSE Information Memo 06-55.

2. **Exclusions from Research Report Definition.**⁴

- a. Written or electronic communications limited to the following are not considered Research Reports:
- (i) Discussions of broad-based indices;
 - (ii) Commentaries on economic, political or market conditions;
 - (iii) Technical analyses concerning demand and supply for a sector, index or industry based on trading volume and price;
 - (iv) Statistical summaries of multiple companies' financial data, including listings of current ratings;
 - (v) Recommendations regarding increasing or decreasing holdings in particular industries or sectors; or
 - (vi) Notices of ratings or price target changes, provided that the member firm simultaneously directs the readers of the notice to the most recent Research Report on the Subject Company that includes all current applicable disclosures required by this rule, and that such Research Report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable.
- b. The following types of written or electronic communications are not considered Research Reports, even if they include an analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision:
- (i) Any communication distributed to fewer than 15 persons;
 - (ii) Periodic reports or other communications prepared for discretionary investment account clients or investment company shareholders or that discuss individual securities in the context of a discretionary account's or fund's past performance or the basis for previously made discretionary investment decisions; or
 - (iii) Internal communications that are not given to current or prospective customers.

⁴ NASD and NYSE have proposed to amend the definition of "Research Report" to exclude sales material regarding: (a) open-end registered investment companies that are not listed or traded on an exchange (*i.e.*, research on ETFs would continue to be covered whereas research on mutual funds would not be covered); and (b) public direct participation programs.

- c. Communications that constitute statutory prospectuses that are filed as part of the registration statement are not considered Research Reports.
- B. Research Analyst (NASD Rule 2711(a)(6), NYSE Rule 472.40; see also Rule 500 of Regulation AC).** The term “Research Analyst” includes the person who is primarily responsible for the preparation of the substance of a Research Report and any person who reports directly or indirectly to that person, whether or not any such person has the job title of “Research Analyst.”⁵
- C. Research Analyst Account (NASD Rule 2711(a)(7); see also NYSE Rule 472.40).** A Research Analyst Account is any account in which a Research Analyst or member of the Research Analyst’s household has a financial interest, or over which the Research Analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. The term Research Analyst Account does not include a “blind trust” account that is controlled by a person other than the Research Analyst or member of the Research Analyst’s household where neither the Research Analyst nor a member of the Research Analyst’s household knows of the account’s investments or investment transactions.
- D. Public Appearance (NASD Rule 2711(a)(5), NYSE Rule 472.50; see also Rule 500 of Regulation AC).** A Public Appearance is any participation by a Research Analyst in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons or before one or more representatives of the media; a radio, television or print media interview; or the writing of a print media article, in which a Research Analyst makes a recommendation or offers an opinion concerning an equity security. The definition of the term Public Appearance does not include a password protected webcast, conference call or similar event with 15 or more existing customers. However, this exception requires that all of the event participants have previously received the most current Research Report or other documentation, with the required applicable disclosures concerning the equity security or securities discussed during the appearance, and that the Research Analyst appearing at the event corrects and updates during the appearance any disclosures in the Research Report or other documentation that are inaccurate, misleading or no longer applicable.
- E. Investment Banking Services (NASD Rule 2711(a)(3), NYSE Rule 472.20).** Investment Banking Services include, without limitation, acting as an underwriter or participating in a selling group in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, private investment, public equity transactions (PIPEs) or similar investments; or serving as placement agent for the issuer.

⁵ NASD has proposed to narrow the definition of “Research Analyst” to persons whose “primary” job function is to provide investment research.

- F. **Subject Company (NASD Rule 2711(a)(10), NYSE Rule 472.60).** A Subject Company is the company whose equity securities are the subject of a Research Report or a Public Appearance.

II. REGISTRATION OF RESEARCH PERSONNEL

- A. **Registration of Research Analysts (NASD Rule 1050, NYSE Rule 344 and Interpretation /01 thereto).** Research Analysts generally must pass the Series 7 and the Series 86 and 87. However, NASD and NYSE have adopted exemptions from this general registration requirement.

1. **General Exemption.** Upon request of a member firm, NASD and NYSE may grant a waiver from the Series 86 upon verification that:

- a. The applicant has passed Levels I and II of the Chartered Financial Analyst (“CFA”) Examination or Levels I and II of the Chartered Market Technician (“CMT”) Examination (if the applicant functions as a Research Analyst who prepares only technical Research Reports (as defined in NASD Rule 1050(e) and NYSE Rule 344 /01); and
- b. The applicant has either functioned as a Research Analyst continuously since having passed the Level II CFA or CMT examination or applied for registration as a Research Analyst within two years of having passed the Level II CFA or CMT examination.

2. **Exemption for Foreign Research Analysts.**

- a. **Current Exemption.** The registration requirements do not apply to an associated person who is an employee of a non-member foreign affiliate and who contributes to the preparation of a member’s Research Report (“foreign research analyst”), provided the following conditions are met:
 - (i) The foreign research analyst resides and is employed in a jurisdiction that NASD and NYSE have determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with this rule and the research analyst conflict of interest rules pursuant to NASD Rule 2711 and NYSE Rule 472;⁶
 - (ii) The foreign research analyst has satisfied all applicable registration and qualification requirements or other

⁶ NASD and NYSE have approved seven jurisdictions that meet the applicable standard: the United Kingdom, China, Hong Kong, Singapore, Thailand, Malaysia, and Japan. See NASD Notice to Members 05-24 and NYSE Information Memo 05-23.

research-related standards in the jurisdiction in which the foreign research analyst resides and is employed;

- (iii) The U.S. member firm whose Research Reports a foreign research analyst contributes in the preparation of has imposed on its affiliates and the foreign research analysts they employ all of the provisions of NASD Rule 2711 and NYSE Rule 472 and all other research-related standards the member imposes on its own Research Reports and research analysts;
- (iv) The annual compliance attestation submitted by the U.S. member firm pursuant to NASD Rule 2711(i) and NYSE Rule 351(f) must encompass the global application of NASD Rule 2711 and NYSE Rule 472 to the U.S. member's foreign affiliates that participate in the preparation of the U.S. member's Research Reports;
- (v) All U.S. member firm Research Reports to which a foreign research analyst contributes in the preparation must be approved by a properly registered principal or supervisory analyst pursuant to NASD Rule 1022 and NYSE Rule 472; and
- (vi) In addition to the disclosure requirements of NASD Rule 2711 and NYSE Rule 472, each U.S. member firm Research Report to which a foreign research analyst contributes in the preparation shall include the following on the front page:
 - (a) A statement that: "This research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member firm. These research analysts are not registered/qualified as a research analyst with the NYSE and/or NASD, but instead have satisfied the registration/qualification requirements or other research-related standards of a foreign jurisdiction that have been recognized for these purposes by the NYSE and NASD";
 - (b) Disclosures identifying each affiliate contributing to the Research Report, the location of such affiliate, and the names of the research analysts employed by the affiliate that contributed to the preparation of the Research Report;
 - (c) A general description of the relationship between the contributing affiliates and the U.S. member; and

(d) A reference to the page on which a separate “Foreign Affiliate Disclosures” section can be found. Such section shall disclose information on the nature of the affiliation between the entities, the affiliates’ addresses, and the primary regulator in the jurisdiction(s) in which each affiliated entity is located.

(vii) Members must establish and maintain records that identify those individuals who have availed themselves of the exemption for foreign research analysts, specify the basis for such exemption, and evidence compliance with the conditions of the exemption.

b. **Proposed Amendments to Exemption for Foreign Research Analysts**

(i) FINRA has filed a proposed rule change with the SEC to amend the exemption for foreign research analysts.⁷ Under the proposed rule change, registration requirements for Research Analysts would not apply to an associated person who (1) is an employee of a nonmember foreign affiliate of a member firm (“foreign research analyst”), (2) resides outside the United States and (3) contributes, partially or entirely, to the preparation of globally-branded⁸ or foreign affiliate Research Reports but does not contribute to the preparation of a member’s research, including a Mixed-Team Research Report,⁹ that is not globally-branded.

(ii) Eligibility for the exemption would further be conditioned on the member meeting certain supervisory, disclosure and recordkeeping requirements.

(a) **Supervisory Requirements.** Member firms that publish or otherwise distribute globally-branded Research Reports partially or entirely prepared by a

⁷ File No. SR-FINRA-2007-10 (filed with the SEC on September 12, 2007). The SEC has not yet taken action on the proposed rule change. Prior to the formation of FINRA, NASD and NYSE filed similar proposed rule changes regarding foreign research analysts. See File No. SR-NASD-2007-57 (filed with the SEC on July 27, 2007) and File No. SR-NYSE-2007-73 (filed with the SEC on July 27, 2007). Those proposals were subsequently withdrawn and refiled in File No. SR-FINRA-2007-10.

⁸ Under the proposal, the term “Globally-Branded Research Report” would refer to the use of a single marketing identity that encompasses the member firm and one or more of its affiliates.

⁹ Under the proposal, the term “Mixed-Team Research Report” would refer to any member firm Research Report that is not globally-branded and includes a contribution by a research analyst who is not an associated person of the member.

foreign research analyst would be required to subject such research to pre-use review and approval by a registered principal in accordance with NASD Rule 1022(a)(5) and interpretations thereto in Notice to Members 04-81 and 07-04, or a supervisory analyst pursuant to NYSE Rule 344.11. In addition, the member firm organization would be required to ensure that such Research Reports comply with NASD Rule 2711 and NYSE Rule 472, as applicable.

- (b) **Disclosure Requirements.** In publishing or otherwise distributing globally-branded Research Reports partially or entirely prepared by a foreign research analyst, a member firm would be required to prominently disclose on the front page of each such Research Report: (1) each affiliate contributing to the Research Report; (2) the names of the foreign Research Analysts employed by each contributing affiliate; (3) that such Research Analysts are not registered/qualified as research analysts with the NYSE and/or NASD; and (4) that such Research Analysts may not be associated persons of the member firm and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a Subject Company, Public Appearances and trading securities held by a Research Analyst Account.
- (c) **Recordkeeping Requirements.** 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. Failure to establish and maintain such records would create an inference of a violation of NASD Rule 1050 and NYSE Rule 344. Member firms would also be required to establish and maintain records that evidence compliance with the applicable content, disclosure and supervision provisions of NASD Rule 2711 and NYSE Rule 472. In addition, member firms would be required to maintain these records in accordance with the supervisory requirements of NYSE Rule 342 and NASD Rule 3010, and in addition to such requirement, the failure to establish and maintain such records would create an inference of a violation of the

applicable content, disclosure and supervision provisions of NYSE Rule 472 and NASD Rule 2711.

- B. Supervisors of Research Analysts (NASD Rule 1022(a)(5), NYSE Rule 344.11).** Personnel of the member firm who supervise Research Analysts and approve the content of Research Reports must pass the Series 24 and the Series 87.

III. SUPERVISION AND APPROVAL OF RESEARCH REPORTS

- A. Research Reports Prepared by the Member Firm (NASD Rule 2210(b), NYSE Rule 472(a)(1)).** All Research Reports prepared by the member firm must be approved, by signature or initial, by an approved "Supervisor of Research Analysts" (*i.e.*, a Series 24 principal who also has passed the Series 87).

- B. Third-Party Research Reports (NASD Rule 2711(h)(13)(C), NYSE Rule 472(a)(2)).**

1. All Research Reports prepared by a third party and distributed by the member firm¹⁰ must be approved, by signature or initial, by a Series 24 Registered Principal and must be reviewed to determine that the applicable third-party disclosures required by NASD Rule 2711 and NYSE Rule 472 are complete and accurate ("Disclosure Review"). In addition, the Registered Principal must determine that the content of the Research Report is consistent with all applicable standards regarding communications with the public ("Content Review").¹¹ A principal does not have to have the Series 87 in order to review third-party Research Reports, but the principal must be qualified by virtue of experience and training to carry out the review.
2. FINRA has filed a proposed rule change with the SEC to amend the Disclosure Review and Content Review requirements.¹² Under the

¹⁰ NASD and NYSE have stated that a member firm is not considered to have "distributed" a Research Report where the firm makes an independent third-party Research Report available to its customers either upon request or through a firm-maintained website. However, a member firm is considered to have distributed a Research Report prepared by an affiliated third party if the Research Report is either requested by a customer or made available on a member-maintained website. See NASD Notice to Members 07-04; NYSE Information Memo 07-11.

¹¹ NASD and NYSE have stated that a firm's obligation to review the content of a third-party Research Report in this regard extends to any untrue statement of a material fact or any false or misleading information. See NASD Notice to Members 07-04; NYSE Information Memo 07-11.

¹² File No. SR-FINRA-2007-11 (filed with the SEC on September 12, 2007). The SEC has not yet taken action on the proposed rule change. Prior to the formation of FINRA, NASD and NYSE filed similar proposed rule changes regarding the Disclosure Review and Content Review requirements. See File No. SR-NASD-2007-050 (filed with the SEC on July 25, 2007) and File No. SR-NYSE-2007-66 (filed with the SEC on July 24, 2007). Those proposals were subsequently withdrawn and refiled in File No. SR-FINRA-2007-11.

proposal, the Content Review requirement would be eliminated for “Independent Third-Party Research Reports”¹³ when a member distributes or makes available such research. In addition, the proposal would create an exception from the Disclosure Review requirement for Independent Third Party Research Reports that are made available by a member firm either (a) upon request, (b) through a member-maintained web site, or (c) where such report is made available by a member to a customer in connection with a solicited order in which the registered representative has informed the customer, during the course of the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

IV. REQUIRED CONTENT AND DISCLOSURES

A. Certifications under Regulation AC.

1. ***Certifications in Research Reports (Rule 501 of Regulation AC).*** Regulation AC provides that a Research Report published by a broker-dealer must include a *clear and prominent certification*¹⁴ by the Research Analyst attesting: (1) that the views expressed in the Research Report accurately reflect the Research Analyst’s personal views about the subject securities or issuers; and (2) either that no part of the Research Analyst’s compensation is related to the specific recommendations or views in the Research Report or, if some or all of the analyst’s compensation is related to the recommendations or views, identifying the compensation and further disclosing that the compensation could influence the recommendations or views expressed in the Research Report.
2. ***Certifications in Connection with Public Appearances (Rule 502 of Regulation AC).*** If the firm publishes a Research Report, it must make a record within 30 days after any calendar quarter in which the Research Analyst made a Public Appearance that contains statements attesting:
 - a. That the views expressed by the Research Analyst in all Public Appearances during the calendar quarter accurately reflected the

¹³ Under the proposal, the term “Independent Third-Party Research Report” would be defined to mean a Third-Party Research Report in respect of which the person or entity producing the report (1) 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 (2) makes coverage and content determinations without any input from the distributing member or that member’s affiliates. The term “Third-Party Research Report” would be defined as a Research Report that is produced by a person or entity other than a member firm.

¹⁴ In adopting Regulation AC, the SEC stated that it expects that the certifications will be included on the front page of the Research Report, or that the front page will specify the page or pages on which each certification is found, and that electronic Research Reports may utilize hyperlinks to the disclosure, provided that the first screen that the investor sees clearly and prominently labels the hyperlinks to the required disclosures. See Securities Exchange Act Release No. 47384 (February 20, 2003), 68 FR 9482, 9483 (February 27, 2003).

Research Analyst's personal views at that time about the subject securities or issuers; and

- b. That no part of the Research Analyst's compensation is related to the specific recommendations or views expressed by the Research Analyst in the Public Appearances.

B. Disclosures Required Pursuant to NASD and NYSE Rules.¹⁵

1. **Meaning of Ratings (NASD Rule 2711(h)(4), NYSE Rule 472(k)(1)(i)(f)).** Research Reports must describe the meaning of all ratings in the member firm's rating system.
2. **Distribution of Ratings (NASD Rule 2711(h)(5), NYSE Rule 472(k)(1)(i)(g)).** Regardless of the member firm's actual rating system, a Research Report must disclose:
 - a. The percentage of all securities rated by the member firm to which the member firm would assign a "buy," "hold/neutral," or "sell" rating; and
 - b. The percentage of Subject Companies within each of the three rating categories for which the member firm has, within the previous 12 months, provided Investment Banking Services.
3. **Price Charts (NASD Rule 2711(h)(6), NYSE Rule 472(k)(1)(i)(h)).** If the member firm has rated a security of a Subject Company for at least one year, the Research Report must include a chart that maps the historical daily closing price movements of the security and indicates the points at which the member firm assigned or changed a research rating or price target. The price chart must be current as of the end of the most recent calendar quarter, but does not have to extend more than three years prior to the date of the Research Report.
4. **Price Targets (NASD Rule 2711(h)(7), NYSE Rule 472(k)(1)(i)(e)).** If a Research Report contains a price target for a Subject Company, it must disclose the valuation method used to determine the price target and a disclosure concerning risks that may impede achievement of the price target.

¹⁵

NASD and NYSE have proposed to permit member firms, in lieu of publication in the Research Report itself, to disclose conflicts of interest by including a prominent warning on the cover of a Research Report that such conflicts of interest exist, together with information on how the reader may obtain more detail about these conflicts on the member's website. Firms would be required to include detailed conflicts information on the website. However, this proposal would not apply to certain other disclosures, such as the meanings of the member's ratings and the price chart showing the Subject Company's price movements against the analyst's assignments of ratings and price targets.

5. **Disclosure of Ownership and Material Conflicts of Interest (NASD Rule 2711(h)(1), NYSE Rule 472(k)(1)).** The member firm must disclose in Research Reports, and Research Analysts must disclose in Public Appearances, if:

- a. The Research Analyst or a member of the Research Analyst's household¹⁶ has a financial interest in securities of the Subject Company as well as the nature of the financial interest (*e.g.* whether it consists of any option, right, warrant, future, long or short position);
- b. The member firm or its affiliates beneficially owned 1% or more of any class of the Subject Company's equity securities as of the end of the month immediately preceding the date of publication of the Research Report or of the Public Appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month);¹⁷ or
- c. There is any other actual, material conflict of interest that the Research Analyst knows, or has reason to know, at the time of publication or the Public Appearance.

C. Disclosure of Compensation and Services (NASD Rule 2711(h)(2), NYSE Rule 472(k)(1)).

1. Research Reports must disclose receipt of the following types of compensation and services:
 - a. If the member firm:
 - (i) Managed or co-managed a public offering of a Subject Company's securities in the last 12 months;
 - (ii) Received compensation for Investment Banking Services from the Subject Company within the last 12 months; or
 - (iii) Expects to receive or intends to seek compensation for Investment Banking Services from the Subject Company within the next 3 months.

¹⁶ NASD Rule 2711(a)(4) and NYSE Rule 472.40 define "member of a research analyst's household" to mean any individual whose principal residence is the same as the Research Analyst's principal residence. However, Rule 2711(a)(4) and NYSE Rule 472.40 also provide that the term does not include an unrelated person who shares the same residence as a Research Analyst, provided that the Research Analyst and the unrelated person are financially independent of one another.

¹⁷ NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)(c) state that computation of beneficial ownership of securities is to be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Exchange Act.

- b. If the Research Analyst received compensation:
 - (i) Based in whole or in part on revenues from the member firm's Investment Banking Services; or
 - (ii) From the Subject Company within the past 12 months.

- c. The types of services provided to the Subject Company (described as Investment Banking Services, non-Investment Banking Services, and non-securities services) **if**, as of the end of the month immediately preceding the date of publication of the Research Report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month), **or** to the extent the Research Analyst or an employee of the member firm with the ability to influence the substance of the research¹⁸ knows that:
 - (i) The member firm received any compensation for products or services other than Investment Banking Services from the Subject Company in the past 12 months; or
 - (ii) The Subject Company currently is, or during the 12-month period preceding the date of distribution of the Research Report was, a client of the member firm.

- d. If an affiliate of the member firm received any compensation for products or services other than Investment Banking Services from the Subject Company in the past 12 months:
 - (i) **To the extent** the Research Analyst or an employee of the member firm with the ability to influence the substance of the Research Report **knows** of such receipt; or
 - (ii) To the extent the Research Analyst or the member firm **has reason to know** of such receipt, provided that:
 - (a) The requirement to disclose compensation that the Research Analyst or the member firm has reason to know will be deemed satisfied if the compensation is disclosed in Research Reports within 30 days after completion of the last calendar quarter, provided that the member firm has taken steps reasonably designed to identify any such compensation during that calendar quarter (this

¹⁸ For the purposes of NASD Rule 2711 and NYSE Rule 472, an employee of the firm with the ability to influence the substance of the Research Report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular Research Report and to change that Research Report prior to publication.

requirement does not apply to any Subject Company as to which the member firm initiated coverage since the beginning of the current calendar quarter); and

- (b) The Research Analyst and the member firm will be presumed not to have reason to know whether an affiliate received any compensation for products or services other than Investment Banking Services from the Subject Company in the past 12 months if the member firm maintains and enforces policies and procedures reasonably designed to prevent the Research Analysts and employees of the member firm with the ability to influence the substance of Research Reports from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.

D. Other Disclosures.

1. **Market Making (NASD Rule 2711(h)(8), NYSE Rule 472(k)(1)(i)(b)).** The member firm must disclose in Research Reports whether it makes a market in the Subject Company's securities.
2. **Position as Officer or Director (NASD Rule 2711(h)(3), NYSE Rule 472(k)(1)(iii)(c)).** The member firm must disclose in Research Reports, and the Research Analyst must disclose in Public Appearances, if the analyst, or a member of the analyst's household, is an officer, director or advisory board member of the Subject Company discussed in the Research Report or Public Appearance.
3. **Disclosures in Compendium Reports (NASD Rule 2711(h)(11), NYSE Rule 472(k)(1)(iii)(d)).** If a Research Report covers six or more companies, the member firm may direct the reader in a clear and prominent manner as to where the reader may obtain applicable current disclosures in written or electronic format.

E. Disclosures on Third-Party Research Reports (NASD Rule 2711(h)(13), NYSE Rule 472(k)(4)). If the member firm distributes Research Reports prepared by a third party (e.g., another broker-dealer, a non-broker-dealer affiliate, or an independent third party), the member firm is only required to disclose with those Reports:

1. If the member firm or its affiliates beneficially owned 1% or more of any class of the Subject Company's equity securities as of the end of the month immediately preceding the date of publication of the Research Report (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month);

2. If the member firm: (a) managed or co-managed a public offering of a Subject Company's securities in the last 12 months; (b) received compensation for Investment Banking Services from the Subject Company within the last 12 months; or (c) expects to receive or intends to seek compensation for Investment Banking Services from the Subject Company within the next 3 months;
3. If the member firm makes a market in the Subject Company's securities; and
4. Any other actual, material conflict of interest of the member firm.¹⁹

V. RESTRICTIONS RELATING TO PUBLIC OFFERINGS OF SECURITIES²⁰

A. Restrictions on Distributing Research Reports after Public Offerings (NASD Rule 2711(f)(1), NYSE Rule 472(f)(1)).²¹

1. ***Member Firm Acting as Manager or Co-Manager of an Offering.***
 - a. If the member firm acts as manager or co-manager of a public offering of securities for a Subject Company, the member firm may not publish or otherwise distribute a Research Report, and a Research Analyst may not make a Public Appearance, regarding the Subject Company:
 - (i) For 40 calendar days *following* the date of an initial public offering;²² or

¹⁹ FINRA has filed a proposed rule change with the SEC that would allow a member firm 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. See File No. SR-FINRA-2007-11 (filed with the SEC on September 12, 2007).

²⁰ NASD and NYSE have stated that these restrictions would not apply to private placements of Rule 144A securities and Regulation S offerings, but rather that they would apply only to offerings of securities that must be registered for offer or sale in the United States. See *Joint Memorandum of NASD and the New York Stock Exchange, Discussion and Interpretation of Rules Governing Research Analysts and Research Reports* (March 9, 2004) ("2004 Joint Memo"), NASD Notice to Members 04-18, NYSE Information Memo 04-10.

²¹ NASD and NYSE have proposed to amend these requirements to establish a uniform 25-day quiet period following IPOs and to eliminate the quiet period following secondary public offerings of securities. In addition, the proposals would extend the quiet period restrictions to all member firms that have agreed to participate or are participating as an underwriter or dealer in an IPO (*i.e.*, not just managers and co-managers), including selling group members operating on a "best efforts" basis.

²² NASD Rule 2711(f)(3) and NYSE Rule 472.120 provide that, for purposes of the quiet periods following IPOs and secondary public offerings, the terms "date of the offering" and "offering date" refer to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

- (ii) For 10 calendar days *following* the date of a secondary public offering.

b. **Exceptions.**

- (i) During the 40-day or 10-day periods following an IPO or secondary offering, the member firm may publish or otherwise distribute a Research Report, and a Research Analyst may make a Public Appearance concerning the effects of significant news or a significant event on the Subject Company. A Research Report issued pursuant to this exception must be limited to discussing the effects of the news or event that triggered the exception. However, the report may contain or update a price target, rating or recommendation concerning the Subject Company's securities.²³ In addition, legal or compliance personnel must authorize publication of the Research Report before it is issued or authorize the Public Appearance before it is made.
- (ii) During the relevant period following secondary offerings, a member firm may publish or otherwise distribute a Research Report pursuant to Rule 139 under the Securities Act of 1933 ("1933 Act") regarding a Subject Company with "actively-traded securities," as defined in Regulation M,²⁴ and a Research Analyst may make a Public Appearance regarding such a Subject Company.

2. ***Member Firm Acting as Underwriter or Dealer in an IPO.*** If a member firm has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer's initial public offering, the member firm may not publish or otherwise distribute a Research Report, and a Research Analyst may not make a Public Appearance, regarding that issuer for 25 calendar days after the date of the offering.

²³ See 2004 Joint Memo.

²⁴ Under Rule 101(c)(1) of Regulation M, a company with actively-traded securities is a company whose securities have an average daily trading volume value of at least \$1 million and are issued by a company whose publicly issued securities have a public float value of at least \$150 million.

B. Expiration of Lock-Up Agreements (NASD Rule 2711(f)(4), NYSE Rule 472(f)(3)).²⁵

1. If the member firm has acted as a manager or co-manager of a public securities offering, it may not publish or otherwise distribute a Research Report, and a Research Analyst may not make a Public Appearance, concerning a Subject Company for a period beginning 15 days prior to and ending 15 days after the expiration, waiver or termination of a “lock-up” agreement or any other agreement that the member firm has entered into with the Subject Company or its shareholders that restricts or prohibits the sale of securities held by the Subject Company or its shareholders after the completion of a securities offering.
2. **Exceptions.** During the black-out period relating to lock-up agreements:
 - a. A member firm may publish or otherwise distribute a Research Report concerning the effects of significant news or a significant event on the Subject Company, provided that legal or compliance personnel authorize publication of that Research Report before it is issued. A Research Report issued pursuant to this exception must be limited to discussing the effects of the news or event that triggered the exception. However, the report may contain or update a price target, rating or recommendation concerning the Subject Company’s securities.²⁶ In addition, legal or compliance personnel must authorize publication of the Research Report before it is issued or authorize the Public Appearance before it is made.
 - b. A member firm may publish or otherwise distribute a Research Report pursuant to Rule 139 under the 1933 Act regarding a Subject Company with “actively-traded securities,” as defined in Regulation M, and a Research Analyst may make a Public Appearance regarding such a company.

²⁵ NASD has proposed to eliminate the formal quiet period surrounding the expiration of lock-up agreements, but it also has proposed requiring member firms to certify in any Research Report issued within 15 days before and after a lock-up expiration that there is a “bona fide” reason to issue the Research Report. NYSE has proposed to reduce the quiet period surrounding the expiration of lock-up agreements from 15 days to five days.

²⁶ See 2004 Joint Memo.

VI. RESEARCH ANALYST PERSONAL TRADING RESTRICTIONS.

A. **Prohibited Transactions (NASD Rule 2711(g)(1)-(3), NYSE Rule 472(e)(1)-(3)).** Research Analyst Accounts are prohibited from engaging in the following types of transactions:

1. Purchasing or receiving pre-IPO shares of an issuer that is principally engaged in the same types of business as companies that the Research Analyst follows.²⁷
2. Trading any security issued by a company that the Research Analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending five calendar days after the publication of a Research Report concerning the company or a change in a rating or price target of the company's securities; provided that:
 - a. The member firm may permit a Research Analyst Account to sell securities held by the account that are issued by a company that the Research Analyst follows within 30 calendar days after the Research Analyst began following the company for the member firm; and
 - b. The member firm may permit a Research Analyst Account to purchase or sell any security issued by a Subject Company within 30 calendar days before the publication of a Research Report or change in the rating or price target of the Subject Company's securities due to significant news or a significant event concerning the Subject Company, as long as legal or compliance personnel pre-approve the Research Report and any change in the rating or price target.
3. Trading a security, or any option on or derivative of such security, in a manner inconsistent with the Research Analyst's recommendation as reflected in the most recent Research Report published by the member firm.

B. **Transactions Subject to Pre-Approval (NASD Rule 2711(g)(6), NYSE Rule 472(e)(5)).** Personal transactions of persons who oversee Research Analysts must be pre-approved by legal or compliance personnel to the extent the transactions involve equity securities of Subject Companies covered by the

²⁷ NASD and NYSE have stated that: "As a general matter, a member should assume that an issuer falls within this category if the issuer would be assigned to the analyst if the member began covering the issuer. To the extent that there are still questions, an acceptable approach would be to include all companies that are classified as being in the same industry as the companies that the analyst covers by a nationally recognized system of industry classification." *Joint Memorandum of NASD and the New York Stock Exchange, Discussion and Interpretation of Rules Governing Research Analysts and Research Reports* (June 26, 2002), NASD Notice to Members 02-39, NYSE Information Memo 02-26.

Research Analysts that they oversee. The pre-approval requirement applies to all persons who have direct influence or control with respect to the preparation of the substance of Research Reports or establishing or changing a rating or price target of a Subject Company's equity securities.

C. Exceptions to Personal Trading Restrictions.²⁸

1. General Exceptions (NASD Rule 2711(g)(5), NYSE Rule 472(e)(4)).

The personal trading restrictions do not apply to securities transactions involving:

- a. Shares of any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940 (including ETFs that are registered diversified investment companies); or
- b. Any other investment fund over which neither the Research Analyst nor a member of the Research Analyst's household has any investment discretion or control, provided that:
 - (i) The Research Analyst Accounts collectively own interests representing no more than 1% of the assets of the fund;
 - (ii) The fund invests no more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies that the Research Analyst follows; and
 - (iii) If the investment fund distributes securities in kind to the Research Analyst or household member before the issuer's initial public offering, the Research Analyst or household member must either divest those securities immediately or the Research Analyst must refrain from participating in the preparation of Research Reports concerning that issuer.²⁹

²⁸ In addition to the exceptions described below, NASD and NYSE have proposed to create an exception for member firms that voluntarily choose to prohibit their Research Analysts from owning shares of the companies they cover. The proposed exception would allow such a firm to adopt policies and procedures that permit Research Analysts to divest their holdings in an orderly and controlled manner with the oversight of the firm's legal and compliance personnel.

²⁹ NASD has proposed to extend the investment fund exception to its personal trading requirements to any investment fund, provided that: (a) neither the analyst nor a member of the analyst's household is made aware of the fund's holdings or transactions other than through periodic shareholder reports and sales material based on such reports; and (b) the analyst and household members collectively own no more than 1% of the assets of the fund. NYSE declined to make a similar proposal, and would retain the current 1% ownership requirement and the 20% asset diversification test.

2. ***Exceptions Subject to Approval by Legal or Compliance Personnel (NASD Rule 2711(g)(4), NYSE Rule 472(e)(4)(i)).***
 - a. Legal or compliance personnel may authorize an otherwise prohibited personal transaction (except for transactions in pre-IPO shares) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the Research Analyst Account, provided that:
 - (i) Legal or compliance personnel authorize the transaction before it is entered into; and
 - (ii) Each exception is granted in compliance with policies and procedures adopted by the member firm that are reasonably designed to ensure that these transactions do not create a conflict of interest between the professional responsibilities of the Research Analyst and the personal trading activities of a Research Analyst Account.
 - b. The member firm must maintain written records concerning each transaction and the justification for permitting the transaction for three years following the date on which the transaction is approved.

VII. INDEPENDENCE OF RESEARCH FUNCTIONS

A. Independence from Investment Banking.

1. ***Supervision and Control (NASD Rule 2711(b)(1), NYSE Rule 472(b)(1)).***
 - a. A Research Analyst may not be subject to the supervision and control of any employee of the member firm's investment banking department.
 - b. Investment banking personnel may not have any influence over the compensatory evaluation of a Research Analyst.
2. ***Review and Approval of Research Reports by "Non-Research" Personnel (NASD Rule 2711(b)(2)-(3), NYSE Rule 472(b)(2)-(3)).***
 - a. Investment banking personnel and other "non-research" personnel generally may not review or approve a Research Report before publication.
 - b. Non-research personnel may review a Research Report prior to publication to verify the factual accuracy of the report or to identify any potential conflict of interest, provided that:

- (i) Any written communication between non-research personnel and research department personnel concerning the content of a Research Report must be made either through authorized legal or compliance personnel of the member firm or in a transmission copied to such personnel; and
 - (ii) Any oral communication between non-research personnel and research department personnel concerning the content of a Research Report must be documented and made either through authorized legal or compliance personnel acting as intermediaries or in a conversation conducted in the presence of such personnel.³⁰
3. **Small Firm Exception (NASD Rule 2711(k), NYSE Rule 472(m)).** The requirements regarding independence from investment banking do not apply to member firms that over the previous three years, on average per year, have participated in 10 or fewer Investment Banking Services transactions as manager or co-manager **and** generated \$5 million or less in gross Investment Banking Services revenues from those transactions.

B. Independence from Subject Companies (NASD Rule 2711(c), NYSE Rule 472(b)(4)-(6)).

- 1. The member firm generally may not submit a Research Report to the Subject Company before its publication. However, the member firm may submit sections of a Research Report to the Subject Company to verify the factual accuracy of the information of those sections, provided that:
 - a. The sections of the Research Report submitted to the Subject Company do not contain the research summary, the research rating, or the price target;
 - b. A complete draft of the Research Report is provided to legal or compliance personnel before sections of the Research Report are submitted to the Subject Company; and
 - c. If after submitting the sections of the Research Report to the Subject Company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, legal or compliance personnel for the change. The member firm must retain copies of any draft and the final version of such a Research Report for three years following its publication.

³⁰ NASD's proposed amendments to Rule 2711 and NYSE's proposed amendments to Rule 472 would prohibit pre-publication review of Research Reports by *any* non-research personnel, other than legal and compliance personnel.

2. The member firm may notify a Subject Company that it intends to change its rating of the Subject Company's securities, provided that the notification occurs on the business day before the member firm announces the rating change, after the close of trading in the principal market for the Subject Company's securities.
3. A Research Analyst may not participate in efforts to solicit investment banking business and therefore may not, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.³¹
4. A Research Analyst is prohibited from directly or indirectly:
 - a. Participating in a road show related to an Investment Banking Services transaction; and
 - b. Engaging in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an Investment Banking Services transaction.³²
5. Investment banking department personnel are prohibited from directly or indirectly:
 - a. Directing a Research Analyst to engage in sales or marketing efforts related to an Investment Banking Services transaction; and

³¹ NASD and NYSE have stated that they interpret these provisions to prohibit in pitch materials any information about a member firm's research capacity in a manner that suggests, directly or indirectly, that the member firm might provide favorable research coverage. For example, NASD and NYSE stated that they would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. On the other hand, NASD and NYSE stated that a member firm would be permitted to include in the pitch materials the fact of coverage and the name of the Research Analyst because such information alone does not imply favorable coverage. See NASD Notice to Members 07-04; NYSE Information Memo 07-11.

³² NASD and NYSE have stated that they interpret these provisions to permit Research Analysts to listen to (in "listen-only" mode, not identified as being present), or view a live webcast of a road show or other widely attended presentation to investors or the sales force, so long as access is from a remote location (*i.e.*, not at the same address as investment banking personnel, investors or the sales force). NASD and NYSE stated further that, if the road show or other widely attended presentation to investors or the sales force is conducted at the firm's offices, research personnel may listen from the same address as investment banking but may not be in the same room as investment banking personnel, investors or the sales force. See NASD Notice to Members 07-04; NYSE Information Memo 07-11.

In addition, NASD and NYSE have proposed to amend these provisions to extend the prohibition to communications with internal sales personnel in addition to current and prospective customers.

- b. Directing a Research Analyst to engage in any communication with a current or prospective customer about an Investment Banking Services transaction.
6. Any written or oral communication by a Research Analyst with a current or prospective customer or internal personnel related to an Investment Banking Services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

VIII. ADDITIONAL REQUIREMENTS

A. Restrictions on Research Analyst Compensation (NASD Rule 2711(d), NYSE Rule 472(h)).

- 1. **General Restriction.** The member firm may not pay any bonus, salary or other form of compensation to a Research Analyst that is based upon a specific Investment Banking Services transaction.
- 2. **Review of Research Analyst Compensation.**
 - a. The compensation of a Research Analyst who is primarily responsible for the preparation of the substance of a Research Report must be reviewed and approved at least annually by a committee that reports to the member firm's board of directors (or, if the member firm has no board of directors, to a senior executive officer of the member firm). This committee may not have representation from the member firm's investment banking department, and must consider the following factors, as applicable, when reviewing such a Research Analyst's compensation:
 - (i) The Research Analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;
 - (ii) The correlation between the Research Analyst's recommendations and the stock price performance; and
 - (iii) The overall ratings received from clients, sales force, and peers independent of the member firm's investment banking department, and other independent ratings services.
 - b. The committee may not consider as a factor in reviewing and approving a Research Analyst's compensation his or her contributions to the member firm's investment banking business.
 - c. The committee must document the basis upon which each Research Analyst's compensation was established.

- B. Prohibition on Promise of Favorable Research (NASD Rule 2711(e), NYSE Rule 472(g)).** Member firms may not directly or indirectly offer favorable research, a specific rating or a specific price target, or threaten to change research, a rating or a price target, to a company as consideration or inducement for the receipt of business or compensation.
- C. Termination of Research Coverage (NASD Rule 2711(f)(5), NYSE Rule 472(f)(4)).**
1. The member firm must provide notice of its intention to terminate research coverage of a Subject Company by making available a final Research Report on the Subject Company using the means of dissemination equivalent to those it ordinarily uses to provide customers with its Research Reports on the Subject Company.
 2. The final Research Report must be comparable in scope and detail to prior Research Reports and must include a final recommendation or rating, unless it is impracticable for the member firm to produce a comparable report (e.g., if the Research Analyst covering the Subject Company or sector has left the member firm or if the member firm terminates coverage of the industry or sector). If it is impracticable to produce a final recommendation or rating, the final Research Report must disclose the member firm's rationale for the decision to terminate coverage.
- D. Retaliation (NASD Rule 2711(j), NYSE Rule 472(g)(2)).** Member firms and investment banking personnel are prohibited from retaliating (or threatening to retaliate) against Research Analysts for adverse, negative or unfavorable reports that may adversely affect the member firm's investment banking relationship with a Subject Company. Similarly, member firms and investment banking personnel may not retaliate or threaten to retaliate against Research Analysts for adverse, negative or unfavorable views expressed in Public Appearances that may adversely affect the member firm's investment banking relationship with a Subject Company.³³
- E. Supervisory Procedures (NASD Rule 2711(i), NYSE Rule 472(c); see also NYSE Rule 351(f)).** Member firms must adopt and implement written supervisory procedures reasonably designed to ensure that the member firm and its employees comply with the provisions of NASD Rule 2711 and NYSE Rule 472. A senior officer of the member firm must attest annually to NASD and NYSE (as applicable) of each year that it has adopted and implemented those procedures and certify that the analyst compensation review committee reviewed and approved each Research Analyst's compensation and documented the basis upon which this compensation was established.

³³

NASD and NYSE have proposed that the retaliation prohibition be extended to all member firm personnel, not just investment banking personnel.