Joint Report by NASD and the NYSE
On the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules

December 2005

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INTRODUCTION

Beginning in 2002, the New York Stock Exchange ("NYSE") and NASD (together, "the SROs") implemented a series of rule changes ("SRO Rules") to improve objectivity and transparency in equity research and provide investors with more reliable and useful information to make investment decisions. The rules were intended to restore public confidence in the validity of research and the veracity of research analysts, who are expected to function as unbiased intermediaries between issuers and the investors who buy and sell their securities. The trustworthiness of research had eroded due to the pervasive influences of investment banking and other conflicts that had manifest themselves during the market boom of the late 1990s.

Generally, the SRO Rules require clear, comprehensive and prominent disclosure of conflicts of interest in research reports and public appearances by research analysts. The rules further prohibit certain conduct – investment banking personnel involvement in the content of research and determination of analyst compensation, for example – where the conflicts are considered too pronounced to be cured by mere disclosure. Together with the Securities and Exchange Commission's ("SEC" or the "Commission") Regulation Analyst Certification and the settlement terms of certain enforcement proceedings, including the "Global Settlement" among the SROs, the Commission, the North American Securities Administrators Association ("NASAA") and ten[1] of the largest investment banks, the SRO Rules have resulted in sweeping changes to the way firms produce research, utilize and compensate research analysts, and structure the operations of their research and investment banking departments. Evidence suggests that these reforms have resulted in more objective, reliable and valuable research for investors. However, the new rules also have added costs and administrative burdens to firms and contributed to a reduction in research coverage and analyst compensation.

The SEC has requested that the SROs submit this joint report on the operation and effectiveness of the SRO Rules, including any staff recommended changes to the current rule provisions.[2] The report contains six sections. Section I provides background on the conflicts that gave rise to the SRO Rules and sets forth the history of the SRO rulemaking and other regulatory initiatives with respect to research-related activity. Section II discusses the registration and qualification requirements for research analysts and their supervisors, including statistics concerning the levels of registration and qualification. Section III contains a review of SRO examinations, sweeps and enforcement activity since the SRO Rules became effective. Section IV discusses the impact of the SRO Rules as reported in academic studies and media reports and commentary. Section V contains a detailed review of the SRO Rule provisions, including member feedback and recommended changes. Finally, Section VI is the Conclusion.

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1 In August 2004, two additional firms settled with regulators under the same terms as the April 2003 Global Settlement.

2 The views provided in this report are solely those of the NASD and NYSE staffs and have not been endorsed by the Board of Governors of NASD or the Board of Directors of the NYSE.

I. BACKGROUND

A. Conflicts that Led to Regulation

Prior to implementation of the SRO Rules, research analysts were subject to a host of pressures and influences that could – and in many instances, did – compromise the objectivity of their research. The primary biasing forces came from investment bankers who pressured research analysts to speak favorably of current and prospective clients and, with management acquiescence, linked analysts' compensation directly to their role in landing lucrative investment banking deals. In the succinct words of a retired Wall Street research analyst who testified before Congress in the summer of 2001: "Investment banking now dominates equity research."[3] Other conflicts also existed, most notably analysts' personal financial interest in the securities they covered and their firms' ownership positions in covered securities. In addition, research analysts were subject to pressure from subject companies and their major shareholders to maintain favorable ratings.[4]

In testimony before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (the "Subcommittee"), SEC Acting Chair Laura Unger identified a number of then commonplace practices that illustrated the conflicts of interest faced by research analysts.[5] First, research analysts were compensated based on their contributions in support of investment banking transactions and the profitability of that unit. To that end, research analysts typically consulted on possible transactions, participated in road shows and initiated favorable coverage on current and prospective investment banking clients. Moreover, investment bankers at some firms evaluated research analysts for compensation purposes, particularly bonuses.

Second, research analysts provided research reports on companies underwritten by the analysts' firms. Third, research analysts invested in pre-initial public offering ("IPO") private placements of companies they subsequently covered and for which their firms had acted as underwriters. Fourth, research analysts provided investment bankers with prior notice of changes in recommendations. Fifth, research analysts issued "booster-shot" research reports or "buy" recommendations close to expiration of the lock-up period. Such reports served to generate buying interest in the stock and help increase the price while the firm, its clients, or the analysts sold their shares. Sixth, research analysts owned securities in the companies they covered and either failed to disclose those interests or did so in an opaque manner. In some cases, analysts executed trades for their personal accounts that were contrary to the recommendations in their research reports.[6] Finally, analysts rarely revealed any conflicts of interest to investors during

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3 *Analyzing the Analysts: Hearings Before the H. Comm. On Capital Markets, Insurance, and Government Sponsored Enterprises of the Comm. On Financial Services*, 107th Cong., at 243 (2001) (prepared testimony of Ronald Glantz, retired) ("Glantz Testimony").

4 *See, e.g., Analyzing the Analysts* at 251 (prepared testimony of Charles L. Hill, Director of Financial Research, Thomson Financial/First Call) ("analyst objectivity is subject to pressure from four different places": (1) analysts themselves; (2) investment banking; (3) public companies; and (4) institutional shareholders).

5 *Analyzing the Analysts* at 227-240 (written testimony of Laura S. Unger, Acting Chair of the Securities and Exchange Commission) ("Unger Testimony").

6 *Id.* at 233. *See also, e.g., Analyzing the Analysts* at 160 (prepared testimony of Gregg Hymowitz, Founder and Principal of EnTrust Capital Inc.); Glantz Testimony, *supra* note 3; *Analyzing the Analysts* at 266

media appearances in which they routinely recommended securities, and while most firms affirmatively stated that they acted as an underwriter or market maker, others merely stated that they "may" have acted in that capacity.[7]

While these conflicts were not new, they had deepened in the existing market environment. As another witness who testified before the Subcommittee observed:

> [T]he pressures on the analyst have escalated in an environment where penny changes in earnings-per-share forecasts make dramatic differences in share price, where profits from investment-banking activities outpace profits from brokerage and research, where the demographics of the investors who use and rely on sell-side research have shifted, and where investment research and recommendations are now prime-time news.[8]

The industry itself seemed to recognize that the conflicts in research had intensified. As the SROs began rulemaking, discussed in Section I.B below, the industry took steps on its own to address these conflicts. Several firms amended or adopted policies regarding research analysts' ownership of securities of covered companies.[9]

In addition, in June 2001, the Securities Industry Association ("SIA") endorsed a compilation of "best practices"[10] designed to restore the integrity of research and "reaffirm that the securities analyst serves only one master: The investor."[11] The practices were compiled by an ad hoc committee of senior research professionals from the SIA's largest member firms, and included several key recommendations focused on analyst compensation and stock ownership, relations

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(prepared testimony of Adam Lashinsky, Silicon Valley Columnist, The Street.com); *Id.* at 253 (prepared testimony of Matt Winkler, Editor-in-Chief, Bloomberg News).

7 Unger Testimony, *supra* note 5, at 234.

8 *Analyzing the Analysts* at 196 (statement of Thomas A. Bowman, CFA, President and Chief Executive Officer, The Association for Investment Management and Research).

9 For example, Merrill Lynch, Edward Jones and Credit Suisse First Boston announced new policies prohibiting analysts from owning shares in companies they follow. *See id.* at 120 (opening statement of Honorable Paul Kanjorski). Goldman Sachs initiated a policy that would permit analysts to own shares in companies they cover under the following conditions: (1) approval of management and the firm's compliance committee would be required for purchases; (2) purchases would be subject to a minimum 30-day holding period; (3) analysts would be permitted to purchase only stocks that were rated a "trading buy" or already on the firm's recommended list; (4) analysts would be prohibited from selling securities unless they were rated below a "trading buy"; and (5) there would be a twenty-four hour restriction imposed after a change in the rating of a company. *See* Adam Lashinsky, *Wall Street's Discovery of Ethics Is Too Little, Too Late*, TheStreet.com, July 10, 2001, http://www.thestreet.com/markets/adamlashinsky/1486552.html.

Prior to this time, Robertson Stephens had implemented a policy in September 2000 pursuant to which: (1) analysts cannot own stock in companies they cover, and (2) if they already own shares in a company they want to cover, they are required to sell their shares or place them in a blind trust. *Id.*

10 *See Best Practices for Research*, June 2001, and Press Release, *SIA Endorses "Best Practices" To Ensure Ongoing Integrity of Research* (June 21, 2001); *Analyzing the Analysts* at 172 (statement of Marc E. Lackritz, President, SIA).

11 *See Best Practices for Research*, June 2001, and Press Release, *supra* note 10.

with investment banking units and disclosures: (1) research departments should not report to investment banking or any other business units that might compromise their independence, and there should be no outside or investment banking approval of the analyst's opinions or recommendations; (2) analysts' compensation should not be directly linked to specific investment banking transactions, sales and trading revenues or asset management fees; (3) personal financial interests in covered securities should be disclosed; and (4) analysts should not trade contrary to their recommendations, except after consultation with research department, legal and/or compliance personnel.[12]

Similarly, in July 2001, the Association for Investment Management and Research ("AIMR"), which is now named the CFA Institute, released a white paper discussing a wide range of potential influences on the objectivity of brokerage-firm research.[13] The white paper also set forth recommendations for a more objective research environment, including: (1) brokerage firm management must foster a corporate culture that fully supports independence and objectivity; (2) firms must establish or reinforce separate reporting structures so that investment banking can never influence a research report or investment recommendation; (3) firms should implement compensation arrangements that do not link analysts' compensation to investment banking work; and (4) firms should require public disclosure of actual conflicts of interest to investors.[14]

However, the guidelines set forth by the industry associations lacked the force and effect of law. Moreover, some lawmakers felt the voluntary industry efforts were inadequate in scope. As Congressman Richard Baker remarked on the second day of hearings before the Subcommittee, "[T]he existing industry association best-practices proposal doesn't go far enough to address the problems, nor, I might add, do subsequent actions taken by individual firms . . . ."[15] Congressman John LaFalce expressed that "more disclosure of these conflicts, in itself will not suffice to protect the individual investor."[16]

B. Summary of Rule Filings and Other Regulatory Actions

1. NASD/NYSE Rule Filings

The SROs enacted the research analyst conflict rules in two primary tranches and, more recently, adopted additional amendments prohibiting analysts from participating in road shows. *See* Exhibit A for the complete text of the SRO Rules. In addition, the SROs supplemented their rulemaking with two joint memoranda that provided interpretive guidance to their members on a number of issues. *See* Exhibits B and C for the joint interpretive memoranda. The NASD and NYSE rules and interpretations are virtually identical and are intended to operate uniformly.

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12 *Id.*

13 *See Preserving The Integrity of Research*, Association for Investment Management and Research (July 2001), and CFA Institute Press Release, *Global Investment Association AIMR Issues Report On Analyst Objectivity* (July 11, 2001).

14 *Id.*

15 *Analyzing the Analysts* at 210 (opening statement of Honorable Richard H. Baker, Chairman).

16 *Id.* at 219 (statement of Honorable John J. LaFalce, Ranking Committee Member).

Round 1 Amendments

In February 2002, the SROs filed the first round of proposed SRO Rules ("Round 1 Amendments") – amendments to NYSE Rules 351 ("Reporting Requirements") and 472 ("Communications with the Public") and new NASD Rule 2711("Research Analysts and Research Reports")[17] – which implemented basic reforms to separate research from investment banking and to provide more extensive disclosure of conflicts of interest in research reports and public appearances.

Generally, the Round 1 Amendments, approved by the SEC on May 10, 2002,[18] achieved the following:

- imposed structural reforms to increase analyst independence, including prohibiting investment banking personnel from supervising analysts or approving research reports;
- prohibited offering favorable research to induce investment banking business;
- prohibited research analysts from receiving compensation based on a specific investment banking transaction;
- required disclosure of financial interests in covered companies by the analyst and the firm;
- required disclosure of existing and potential investment banking relationships with subject companies;
- imposed quiet periods for the issuance of research reports after securities offerings managed or co-managed by a member;
- restricted personal trading by analysts;
- required disclosure in research reports of data and price charts that help investors track the correlation between an analyst's rating and the stock's price movements; and
- required disclosure in research reports of the distribution of buy/hold/sell ratings and the percentage of investment banking clients in each category.

The Round 1 Amendments were phased-in incrementally to provide members time to implement necessary policies, procedures, systems and other measures to comply with the new

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[17] On February 8, 2002, NASD filed SR-NASD-2002-021. The NYSE filed SR-NYSE-2002-09 on February 27, 2002. On March 7, 2002, NASD filed Amendment No. 1 to SR-NASD-2002-021. The proposals were published for comment in the Federal Register on March 14, 2002. *See* Securities Exchange Act Release No. 45526 (Mar. 8, 2002), 67 FR 11526 (Mar. 14, 2002). On May 1, 2002, NASD filed Amendment No. 2 to SR-NASD-2002-021, and the NYSE filed Amendment No. 1 to SR-NYSE-2002-09.

[18] *See* Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002) (order approving SR-NYSE-2002-09 and SR-NASD-2002-021).

requirements. Most provisions of the SRO Rules went into effect on July 9, 2002; others became effective on September 9, 2002 or November 6, 2002.[19]

Round 2 Amendments and Sarbanes-Oxley

On July 29, 2003, the SEC approved a second set of amendments to the SRO Rules ("Round 2 Amendments")[20] that achieved two purposes. First, the Round 2 Amendments implemented SRO initiatives to further promote analyst objectivity and transparency of conflicts in research reports. The need for some of these additional measures had come to light in the course of joint sweeps undertaken by the SROs and SEC to examine members' research practices for compliance with industry regulations.[21] Among the most significant SRO initiatives included in the Round 2 Amendments were provisions that:

- further insulated analyst compensation from investment banking influence by requiring that a compensation committee, without investment banking representation, review and approve compensation of research analysts and that such compensation be based on the quality of research produced;

- prohibited analysts from participating in the solicitation of investment banking business;

- prohibited analysts from issuing a research report or making a public appearance concerning a subject company around the time of a lock-up expiration, termination or waiver;

- required members to publish a final research report when they terminate coverage of a subject company and provide notice of such termination;

- imposed registration, qualification and continuing education requirements on research analysts (detailed in Section II below); and

- created an exemption from certain rule provisions for firms that engage in limited underwriting activity.

Second, the Round 2 Amendments implemented changes mandated by the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").[22] Sarbanes-Oxley required adoption by July 30, 2003 of rules "reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances," and set forth certain specific rules to be promulgated. Many of those rules had already been adopted in the first round

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19 Certain small firms with limited underwriting activity were granted delayed effectiveness from certain provisions of the SRO Rules until July 2003, at which time a limited exemption was adopted and codified.

20 Securities Exchange Act Release No. 48252 (July 29, 2003), 68 FR 45875 (Aug. 4, 2003) (order approving SR-NYSE-2002-49 and SR-NASD-2002-154).

21 In April 2002, the SROs and the SEC established a Joint Task Force to review practices of designated firms with regard to research reports and recommendations on issuers for which firms had provided or sought investment banking services from January 1999 through April 2002.

22 *See* Section 15D(a) of the Exchange Act, 15 U.S.C. 78o-6.

of SRO rulemaking. The Round 2 Amendments therefore implemented those specific Sarbanes-Oxley rules that did not already exist and conformed the language of the SRO Rules as necessary. Most notably, the Round 2 Amendments satisfied the following Sarbanes-Oxley requirements:

- modified the definition of "research report" to delete the requirement that the communication contain a recommendation;
- extended quiet periods after securities offerings to all firms that participated in the offering as an underwriter or dealer;
- required disclosure of a client relationship and non-investment banking compensation received by a firm from a covered company; and
- prohibited retaliation against research analysts for publishing unfavorable research on an investment banking client.

As with the Round 1 Amendments, the Round 2 Amendments were phased-in incrementally. Most provisions went into effect on September 29, 2003, while certain other provisions did not become effective until October 27, 2003 or January 26, 2004.[23]

Recent Amendment Prohibiting Analyst Participation in Road Shows

On April 21, 2005, the Commission approved an amendment to the SRO Rules that prohibits research analysts from participating in a road show related to an investment banking services transaction and from communicating with current or prospective customers in the presence of investment banking department personnel or company management about such an investment banking services transaction.[24] Additionally, the amendment prohibits investment banking personnel from directing a research analyst to engage in sales and marketing efforts and other communications with a current or prospective customer about an investment banking services transaction.

By prohibiting research analysts from participating in road shows and communicating with customers in the presence of investment bankers or company management, the amendment further reduces pressure on research analysts to give an overly optimistic assessment of a particular transaction. It also removes any suggestion to investors in attendance at a road show that the analyst will give positive coverage to the issuer or that the analyst endorses all of the views expressed by the company or investment banking department personnel.

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[23] In 2004, the SROs delayed the effectiveness of certain disclosure provisions in the rules until April 26, 2004. *See* Securities Exchange Act Release No. 49119 (Jan. 23, 2004), 69 FR 4337 (Jan. 29, 2004) (notice of immediate effectiveness of SR-NASD-2004-003 and SR-NYSE-2004-01).

[24] Securities Exchange Act Release No. 51593 (Apr. 21, 2005), 70 FR 22168 (Apr. 28, 2005) (order approving SR-NASD-2004-141 and SR-NYSE-2005-24). As defined under NASD Rule 2711(a)(2) and NYSE Rule 472.20, "investment banking services" includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

The amendment expressly permits research analysts to educate investors and member personnel about a particular offering or other transaction, provided the communication occurs outside the presence of company management and investment banking department personnel. Such permissible communications to investors and internal personnel must be fair, balanced and not misleading, taking into account the overall context in which such communications are made.[25]

The amendment became effective on June 6, 2005.

2. Joint Memoranda and Interpretations

The Commission noted in its approval order of May 10, 2002 that the SROs would provide interpretive guidance on certain provisions of the SRO Rules. Accordingly, contemporaneous with the first effective date of the new rules, the SROs issued a joint memorandum ("July 2002 Joint Memorandum") providing interpretive guidance on a number of topics, including: the definitions of "investment banking services" and "research report"; public appearances; quiet periods; the applicability of the SRO Rules to third-party research; the prohibition on certain forms of research analyst compensation; restrictions on personal trading by analysts; and requisite disclosures, including the distribution of ratings and price charts (*see* Exhibit B).[26]

In March 2004, the SROs issued a second joint memorandum ("March 2004 Joint Memorandum") to provide further interpretive guidance on the amended SRO Rules (*see* Exhibit C).[27] That memorandum generally addressed issues related to the definition of "research report"; the applicability of the "gatekeeper," blackout and quiet periods provisions; and the scope and prominence of certain disclosure requirements.

The SROs continue to work together on interpretive issues.

3. Other Regulatory Initiatives

Regulation AC

On February 6, 2003, the SEC adopted Regulation Analyst Certification ("Regulation AC"), which took effect on April 14, 2003.[28] Regulation AC generally requires broker-dealers to include in a research report certifications by the analysts who are principally responsible for

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[25] The prohibition on research analysts' participation in road shows does not prohibit certain analysts' communications that are permitted under the federal securities laws. *See* 17 CFR 230.137, 230.138 and 230.139 (research reports issued in accordance with Rules 137, 138 and 139 under the Securities Act of 1933).

[26] *See* NYSE Information Memo No. 02-26 (June 26, 2002), and NASD *Notice to Members* 02-39 (July 2002).

[27] *See* NYSE Information Memo No. 04-10 (Mar. 9, 2004), and NASD *Notice to Members* 04-18 (Mar. 2004).

[28] *See* Regulation Analyst Certification, Securities Exchange Act Release No. 47384 (Feb. 20, 2003), 68 FR 9482 (Feb. 27, 2003). In August 2003 and April 2005, the SEC staff issued additional guidance regarding Regulation AC in a series of questions and answers on the SEC Web site. *See* SEC Responses to Frequently Asked Questions Concerning Regulation Analyst Certification, http://www.sec.gov/divisions/marketreg/mregacfaq0803.htm.

preparing the report (1) that the recommendations or views expressed in the research report accurately reflect the analysts' personal views about the subject securities and issuers, and (2) whether any part of the analysts' compensation was, is, or will be directly or indirectly related to any specific recommendations or views expressed in the research report. In addition, research analysts must certify to the accuracy of statements made in public appearances and that no part of the research analysts' compensation is tied to statements made during the public appearance. If the broker-dealer does not obtain such certification by the analysts, it must disclose this fact and promptly notify its designated examining authority. The SROs continue to examine for compliance with Regulation AC.

Unlike the SRO Rules, Regulation AC applies to both fixed-income and equity research reports and the analysts who are primarily responsible for preparing those reports. Similar to the SRO Rules, Regulation AC broadly defines a "research report" as "a written communication (including an electronic communication) that includes an analysis of a security or an issuer and provides information reasonably sufficient upon which to base an investment decision."

4. Enforcement Proceedings

As the SROs engaged in rulemaking to manage and eradicate existing research conflicts, regulators brought enforcement proceedings to redress past misconduct in the area.

Merrill Lynch Settlement

In May 2002, as part of a settlement with the New York Attorney General, Merrill Lynch agreed to adopt certain changes to its equity research and investment banking activities. Among other things, Merrill Lynch agreed to completely separate analyst compensation from investment banking, prohibit investment banking input into analysts' compensation and disclose in all research reports whether it has received or is entitled to receive any compensation from a covered company over the past 12 months.

The Global Settlement

On April 28, 2003, the SEC, NYSE, NASD, NASAA and the New York Attorney General's Office announced that they had reached an agreement (the "Global Settlement") with ten investment banking firms settling actions alleging fraudulent or misleading research. The United States District Court for the Southern District of New York approved the Global Settlement on October 31, 2003[29] and an amendment to the agreement was approved in September 2004.[30]

The Global Settlement differs in structure from the SRO Rules. The former generally prohibits all communications between research and investment banking personnel, with certain express exceptions. In contrast, the SRO Rules permit all communications that are not expressly prohibited. But the key provisions of the Global Settlement and the SRO Rules are essentially

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[29] *See* SEC Litigation Release No. 18438, 2003 SEC LEXIS 2601 (Oct. 31, 2003).

[30] *See* 03 Civ. 2941 (WHP), 2004 U.S. Dist. LEXIS 19149 (S.D.N.Y. Sept. 24, 2004) (amendments to Addendum A).

the same; the few differences are noted below. A chart comparing the provisions is included as Exhibit D.

The common provisions include prohibitions on review and approval of research by investment banking; prohibitions on research analysts from soliciting investment banking business and participating in sales and marketing activities; requirements for the termination of coverage; general requirements that the compensation of a research analyst primarily responsible for the preparation of the substance of a research report be reviewed and approved by a member firm committee without investment banking representation that reports to the Board of Directors or the senior chief executive officer; and increased disclosure and transparency of potential and actual conflicts of interests and of issues related to the performance of research analysts, such as ratings, price targets and an explanation of the firm's rating system.

Some Global Settlement terms have not been explicitly or implicitly incorporated into the SRO Rules. For example, the Global Settlement requires that the work of the compensation committee be reviewed by an oversight committee of research management. Other Global Settlement requirements not incorporated by the SROs are physical separation between research analysts and investment banking; the requirement that research have its own dedicated legal and compliance staff; and requirements for firms to procure and make available for their clients independent research on listed companies that they cover.

Additionally, comparable SRO Rules and Global Settlement definitions differ in degree and scope. The definitions of "research reports" and "research analysts" are illustrative. The SRO Rules, for example, apply to all research reports produced by the SROs' members, irrespective of where or to whom they are distributed; however, the Global Settlement limits its definition of "research report" to communications furnished to investors in the United States. Also, the SRO Rules' definition of "research analyst" – the same as mandated by the Sarbanes-Oxley Act – is broader than the Global Settlement's definition of "Research Personnel," which is limited to those individuals whose primary job is the preparation of research reports.

The SRO staffs address in Section V whether they recommend incorporating additional Global Settlement terms into the SRO Rules or making any other conforming changes.

II. REGISTRATION AND QUALIFICATION REQUIREMENTS

A. Series 86/87 Examinations

As part of the Round 2 Amendments, the SEC approved rules requiring registration and qualification requirements for research analysts. The SRO Rules require an associated person[31] who functions as a research analyst on behalf of a member to register as such and pass a qualification examination. Those rules are intended to ensure that research analysts possess a certain competency level to perform their jobs effectively and in accordance with applicable rules and regulations. In the context of this requirement, the SRO Rules define "research analyst" as "an associated person who is primarily responsible for the preparation of the

[31] *See* SR-NYSE-2005-24 amending the definition of "research analyst" in NYSE Rules 344.10 and 472.40 to include "associated persons." NASD rules already separately defined "associated person."

substance of a research report or whose name appears on a 'research report,'" as that term is defined in the SRO Rules.

The SROs jointly developed and implemented the Research Analyst Qualification Examination (Series 86/87). The examination consists of an analysis part (Series 86) and a regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate also must have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative Examination (Series 17), or the Canada Module of Series 7 (Series 37 or 38). Persons who were functioning as research analysts on the effective date of March 30, 2004 and submitted a registration application to NASD by June 1, 2004, had until April 4, 2005 to meet the registration requirements. There was no grandfather provision. The one-year grace period was intended to provide these analysts sufficient time to study and pass the examination without causing undue disruption in carrying out their responsibilities to their member firm and its customers.

B. Exemptions

The SRO Rules provide three exemptions from the Series 86 examination. First, there is an exemption for research analysts who have passed Levels I and II of the Chartered Financial Analyst ("CFA") examination and have either (1) completed the CFA Level II within 2 years of application or registration, or (2) functioned as a research analyst continuously since having passed the CFA Level II.[32] A second exemption is available to research analysts who have passed Levels I and II of the Chartered Market Technician Examination and produce only "technical research reports" as that term is defined under the SRO Rules.[33]

A third exemption – from both the Series 86 and Series 87 – is available to "associated persons" of a member who are employed by that member's foreign affiliate but who produce research on behalf of the U.S. member. The SROs created this third exemption in response to requests from some members with global research operations that had difficulty ascertaining whether certain foreign research analysts whose work contributed to the member's research report were "associated persons" who must meet the registration and qualification requirements under the SRO Rules.

To be eligible for the exemption, three primary conditions must be met: (1) a foreign analyst must comply with the registration and qualification requirements or other standards in an SRO-approved foreign jurisdiction whose regulatory scheme reflects a recognition of principles that are consonant with the SRO Rules and qualification standards; (2) the U.S. member must apply all of the other SROs rules and other member firm standards to the research produced by the foreign affiliate and foreign research analysts that qualify for, and rely upon, the exemption; and (3) the U.S. member must include a specific disclosure that the research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member who are not registered/qualified as a research analyst with the NYSE or NASD, but instead have

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[32] *See* Securities Exchange Act Release No. 49464 (Mar. 24, 2004), 69 FR 16628 (Mar. 30, 2004) (order approving SR-NYSE-2004-03 and SR-NASD-2004-020).

[33] *See* Securities Exchange Act Release No. 51240 (Feb. 23, 2005), 70 FR 10451 (Mar. 3, 2005) (notice of immediate effectiveness of SR-NYSE-2005-12 and SR-NASD-2005-022).

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.

Eligibility for the exemption in no way bears upon whether the foreign research analyst is an associated person of the member. And to the extent that a member can determine that a foreign research analyst is *not* an "associated person," there is no requirement to satisfy any of the SRO Rules, including the registration and qualification requirements.

Currently, the following jurisdictions satisfy the applicable SRO standards noted above: China, Hong Kong, Japan, Malaysia, Singapore, Thailand and the United Kingdom. The SROs only considered those jurisdictions submitted by the members that requested the exemption but agreed to consider additional jurisdictions on a case-by-case basis, as requested.[34]

C. Supervisory Requirements

NASD has an additional rule that requires supervisors of research analysts to pass the Series 87 examination or the NYSE Series 16 Supervisory Analyst Examination. Those who oversee the *content* of research reports must have passed either the Series 87 or the Series 16 examination. A registered principal (Series 24) who has also passed either the Series 87 or the Series 16 examination must supervise the conduct of both the Series 16 Supervisory Analyst and the research analyst. The rule became effective on August 2, 2005.[35] NYSE Rule 472(a)(2) requires that a supervisory analyst acceptable under NYSE Rule 344 approve research reports.

D. Statistics

Between April 1, 2004 and November 30, 2005, 5,599 research analysts and 418 research principals had satisfied the applicable registration and qualification requirements. The Series 86 exam was attempted 6,158 times, with an overall pass rate of 74.9%, and the Series 87 exam was attempted 8,259 times, with an overall pass rate of 89.6%. During the same period, 2,375 CFA exemptions and 34 technical analyst exemptions were granted.

III. EXAMINATIONS, SWEEPS AND ENFORCEMENT ACTIONS

The SROs continue to closely examine for compliance with the SRO Rules and rigorously pursue enforcement actions for violations of these rules. The area of research analyst conflicts remains a high priority component of the SROs' examination and enforcement programs.

A. NASD Summary

1. Member Regulation

As the SRO Rules became effective, NASD's Member Regulation Department incorporated into its routine examination program an inspection for compliance with NASD Rule 2711 and SEC Regulation AC.

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[34] The SROs will notify their membership in the event additional jurisdictions are approved.

[35] Securities Exchange Act Release No. 50162 (Aug. 6, 2004), 69 FR 50406 (Aug. 16, 2004) (order approving SR-NASD-2004-078).

Between July 2002 and November 30, 2005, NASD initiated 467 examinations reviewing firms for compliance with Rule 2711 and Regulation AC. In the course of these examinations, NASD found 110 violations of Rule 2711 and 25 violations of Regulation AC. Specifically, the Rule 2711 violations have involved: (1) failure to have adequate procedures in place to supervise the activities of research analysts with respect to conflicts of interest, in violation of Rule 2711(i) (47 of 467 examinations); (2) failure to adequately comply with the disclosure requirements regarding research reports and public appearances, in violation of Rule 2711(h) (24 of 467 examinations); (3) failure to file the Annual Attestation, in violation of Rule 2711(i) (20 of 467 examinations); (4) personal trading of the subject companies' securities in the analyst's account within the restricted time period, in violation of Rule 2711(g) (10 of 467 examinations); and (5) failure to comply with restrictions on communications with the subject company, in violation of Rule 2711(c) (9 of 467 examinations).

Of the 135 violations of Rule 2711 and Regulation AC found to date, 27 have resulted or are expected to result in an Acceptance, Waiver and Consent, seven have resulted in a formal complaint, 18 have resulted in a compliance conference, 81 have resulted in a Letter of Caution, and two remain under investigation.

2. Enforcement

As of November 30, 2005, NASD Enforcement has settled 29 cases involving Rule 2711 violations and two cases involving violations of Rule 1050, the analyst registration rule. By far, the vast majority of settled Enforcement actions have involved violations of the disclosure requirements of Rule 2711(h), encompassing over 265 research reports. Specific violations of this provision include: (1) failure to disclose ownership of shares of subject companies; (2) failure to disclose compensation for investment banking services from the subject company; (3) failure to disclose market making activity; (4) use of conditional language in making the requisite disclosures; (5) failure to provide sufficient price charts; (6) failure to disclose the distribution of buy, hold and sell recommendations; (7) failure to provide information about the valuation methods used; (8) failure to define recommendations; and (9) failure to provide disclosures required by Rule 2210.

Other settled Enforcement cases have involved such violations of Rule 2711 as (1) failure to maintain supervisory procedures pursuant to Rule 2711(i) (113 research reports); (2) communications with subject companies in violation of Rule 2711(c) (17 research reports); and (3) failure to abide by the personal trading restrictions under Rule 2711(g) (21 research reports). In addition, two cases involved analysts offering favorable research reports in exchange for compensation in violation of Rule 2711(e), and one case involved a firm's failure to provide notice of termination of coverage and issue final research reports with respect to seven subject companies, in violation of Rule 2711(f).

Sanctions in the settled Enforcement cases have included fines ranging from $10,000 to $50,000, disgorgement, suspensions and bars in all capacities. In addition, NASD Enforcement has settled with two firms for failure to timely apply for research analyst designation in violation of Rule 1050. These two cases involved 56 analysts and 325 research reports, and each firm was censured and fined (one in the amount of $100,000; the other, $150,000).

There are currently two pending complaints against firms and a number of open investigations involving suspected violations of Rule 2711. These matters involve many of the same compliance issues discussed above, including allegations of failure to meet disclosure obligations and of transgressing the personal trading restrictions. In addition, in summer 2005, the SROs launched a joint sweep of 30 firms to review their compliance with NASD Rules 2711 and 1050 and NYSE Rule 344 in the context of research prepared on behalf of the members by foreign analysts. That review is ongoing.

3. Advertising

Although members need not file research reports with NASD's Advertising Regulation Department, they do constitute "communications with the public" under NASD's advertising rules. As such, NASD's Advertising Regulation Department has conducted two sweeps since NASD Rule 2711 was implemented. In 2002, a sweep of 28 firms was conducted to determine whether firms had made a good faith effort to comply with Rule 2711 and identify any new interpretive issues that might arise. Firms were notified of any compliance shortcomings, with the expectation that those deficiencies promptly would be remedied.

In 2004, NASD's Advertising Regulation Department conducted a second sweep of the ten Global Settlement firms and specifically requested information about their equity research reports (including access to their Web sites), samples of each type of report they used and explanatory material about their ratings. As part of this second sweep, examiners revisited the spot check conducted in 2002 to determine whether firms had made revisions as indicated.

This subsequent review revealed continued deficiencies in several areas. First, some firms were unclear in describing their ratings methodology. For example, some firms failed to explain a two-pronged approach they employed to assess a sector and an individual issuer within that sector. Examiners flagged such reports for failure to comply with the clarity requirement of Rule 2711(h)(10) because the absence of clear ratings descriptions could lead to misconceptions by investors about the firm's actual view of the issuer. Second, some members failed to provide clear disclosure presentations; for example, they used complex systems of footnotes inconsistently and indefinite disclosures (*e.g.*, "may conduct investment banking"). Examiners also identified such practices as violations of Rule 2711's clarity standard. Third, some members failed to use the terms "buy," "hold," and "sell" in the ratings distribution chart, as required by Rule 2711(h)(5). Finally, some members used language that seemed to disclaim responsibility for information in the report about the member firm, including required disclosures of certain conflicts.

NASD's Advertising Regulation Department does not have authority to bring formal actions against members and thus referred to NASD Enforcement those cases where it recommended that further action be considered.

B. NYSE Summary

1. Member Firm Regulation

The NYSE currently has 348 members and member organizations of which 217 are conducting a public business and/or issuing research. The NYSE incorporated the SRO Rule requirements into its exam scope for routine examinations of members and member organizations by Member Firm Regulation ("MFR"), following the effective dates of the SRO Rules in 2002 and 2003.[36]

MFR examiners conducted a series of reviews investigating member and member organization compliance with the SRO Rules and SEC Regulation AC. Between August 2002 and October 2005, MFR conducted a total of 296 examinations.[37] NYSE examiners cited a total of 75 firms with a total of 271 findings for non and/or partial compliance with the SRO Rules and Regulation AC.[38] The findings were distributed as follows: 26 in 2002; 62 in 2003; 152 in 2004; and 31 in 2005.

Specifically, the NYSE examination findings included: (1) failure to clearly and prominently state in research reports in the proper format the disclosures required by the SRO Rules; (2) failure to adhere to the disclosure and record maintenance requirements for associated persons making public appearances; (3) failure to comply with record maintenance requirements evidencing the disclosures in connection with recommendations of securities in print media, interviews, newspaper articles or broadcasts; (4) failure to comply with restrictions on trading activities for associated persons; (5) failure to have legal or compliance personnel intermediate written communications between non-research personnel and research personnel concerning the content of research reports; (6) inclusion of price targets, rating summaries or research ratings information in a draft of a research report sent to a subject company; (7) executing changes to research reports after sending the report to a subject company without proper approval by legal and compliance; (8) allowing research analysts to work under the supervision or control of investment banking department personnel; (9) offering favorable research for business; (10) failure to maintain written procedures for compliance with the SRO Rules; and (11) failure to have a committee in place to review and approve analyst compensation.

2. Enforcement

Between August 2002 and November 2005, 13 examination findings were referred to Enforcement from MFR for SRO Rule violations.[39] As discussed in more detail below, many of

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[36] Only members and member organizations that conducted a public business and/or issued research were examined for compliance with the SRO Rules.

[37] The breakdown of examinations was as follows: 21 firms in 2002, 85 firms in 2003, 140 firms in 2004 and 50 firms in 2005. In many instances the same firm was examined in successive years.

[38] Of the 271 findings, 22 involved Regulation AC. The 22 Regulation AC findings involved: failures by member organizations to maintain clear and prominent disclosures of research analyst certifications; failures to maintain records regarding public appearances of research analysts; failures to specify on the front page of reports the pages on which analyst certifications can be found; failures to have written policies and procedures to prevent inappropriate influences over research analysts; expired or missing certifications; failures with respect to terminated coverage; and missing attestations.

[39] There were also referrals based on findings for Rule 472 prior to its amendment.

these findings are currently the subject of NYSE Enforcement investigation/action, and many have been completed. Recently, a Hearing Panel Decision ("HPD")[40] announced a disciplinary action involving violations of the SRO Rules gatekeeper provisions.[41] This case resulted in consent to censure and a $150,000 fine. Additionally, a member organization has recently consented in a Stipulation of Facts and Consent to Penalty to a fine of $1.5 million in a matter that included, among other things, having a research analyst participate in a road show, and a research analyst giving statements that were not fair and balanced.

There are a number of cases that are now under investigation by NYSE Enforcement. The cases include: research analysts selectively disclosing material non-public information; improper disclosures in research reports; research analysts trading in securities in violation of the SRO Rule blackout prohibitions; research analysts expressing opinions privately about securities they cover that were inconsistent with their published research reports; improper influence of investment banking on research compensation; lack of supervisory analyst qualifications; initiating coverage of a stock during a quiet period; violations of information barrier provisions; violations of the gatekeeper provisions; and books and records violations.

As noted above, there is also an investigation of approximately 30 firms being jointly conducted by the SROs to determine whether firms are in compliance with the requirement to register foreign research analysts who participate in the preparation of member research.

IV. IMPACT OF RULES: ACADEMIC STUDIES AND MEDIA REPORTS

Academic studies and media reports provide both empirical and anecdotal evidence regarding the impact of the SRO Rules,[42] and most have concluded that the rules have helped to address the conflict-of-interest issues that previously compromised the objectivity and reliability of research. Indeed, as the author of one study states:

> [T]he new regulations were successful in their objectives of curbing the excessive optimism driven by the conflicts of interest . . . The distribution of recommendations is now very balanced between buy and sell recommendations . . . and the link between the presence of underwriting business and excess optimism in recommendations was removed.[43]

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40 *See* Exchange HPD 04-136 (NYSE Aug. 11, 2004).

41 The firm was in violation of NYSE Rule 472(b)(4), which prohibits member firms from providing a subject company with draft research reports containing the research summary, rating or price target information.

42 We note that some studies and news articles refer only to the impact of the Global Settlement. Since the key provisions of the Global Settlement closely track those of the SRO Rules, we believe those studies and news articles that address the impact of the settlement terms are a fair proxy for the impact of the SRO Rules.

43 Leonardo Madureira, *Conflicts of Interest, Regulations, and Stock Recommendations*, at 4 (Nov. 2004) (Working paper, Wharton School, University of Pennsylvania) (the "Madureira Study"). *See also, e.g.*, Ohad Kadan, Tzachi Zach & Rong Wang, *Are Analysts Still Biased? The Effect of the Global Settlement and Regulation FD*, Abstract (Mar. 2005) (Working paper, John M. Olin School of Business, Washington

While many other studies and media stories similarly support the effectiveness of the SRO Rules, some contend that the impact has been minimal and that certain conflicts persist. Briefly summarized below are findings and conclusions from a survey of pertinent studies and news articles.

Research Is More Balanced

(a) Changes in ratings distributions

Several academic studies have found that the percentage of buy recommendations decreased and the percentage of sell and hold recommendations increased following adoption of the SRO Rules and Global Settlement. These ratings distribution trends suggest that research analysts are issuing more balanced stock recommendations.

For example, one study found that the percentage of buy recommendations peaked at 74% of all recommendations at the end of the second quarter of 2000 and decreased to 42% of all recommendations at the end of June 2003.[44] During the same period, sell recommendations increased from 2% to 17% of all recommendations, while hold recommendations increased from 24% to 41%.[45]

The Barber Study concludes that "taking a closer look at the trends in 2002 makes clear that [the SRO Rules][46] likely did play a role in analysts' shift away from buy recommendations."[47] Indeed, the study notes that the most pronounced changes in ratings distributions occurred during the weeks leading up to the September 9, 2002 deadline for implementing the ratings distribution disclosure requirement under the SRO Rules.[48] The single biggest change occurred on Sunday, September 8, 2002 when buy recommendations decreased from 57% to 53% and sell recommendations increased from 8% to 11%.[49] Adjusting for certain factors, the authors calculate that there was a greater decrease in the percentage of buys and a greater increase in the percentage of sells and holds following implementation of the SRO Rules than otherwise would have been expected.[50]

University) (the "Kadan Study") ("the Global Settlement was effective in reducing conflicts of interests [sic] between research and investment banking departments in financial services firms").

44 Brad Barber, Reuven Lehavy, Maureen McNichols & Brett Trueman, *Buys, Holds, And Sells: The Distribution Of Investment Banks' Stock Ratings And The Implications For The Profitability Of Analysts' Recommendations*, at 3, 12 (Sept. 2005) (Working paper, Graduate School of Management, University of California, Davis, Ross School of Business, University of Michigan, Graduate School of Business, Stanford University and Anderson Graduate School of Management, University of California, Los Angeles) (the "Barber Study").

45 *Id.*

46 While the authors refer solely to NASD Rule 2711, they state that all conclusions apply to NYSE Rule 472 as well. *Id.* at 1, n.1.

47 *Id.* at 13.

48 *Id.*

49 *Id.* at 13-14.

50 *Id.* at 15.

The Madureira Study found similar results. That study looked at analyst recommendations for the period July 1995 through December 2003 and found that prior to the SRO Rules and Global Settlement, the bulk of consensus recommendations were concentrated in the strong buy and buy categories (accounting for 60% or more of the stocks in the sample) and sell recommendations were "virtually absent."[51] However, from July 2002 through December 2003, "a completely different pattern emerges."[52] For example, in September 2002, the fraction of stocks in the pessimistic category (sell and strong sell) jumped from 3% to approximately 20%.[53] The author found similar patterns with respect to initiation of coverage and ratings upgrades and downgrades, finding that brokerage houses leaned less toward optimistic ratings after the new regulations took effect.[54]

Both the Madureira and Kadan studies found the most decided changes in ratings distributions at firms that maintained or pursued investment banking transactions with covered companies. The Madureira Study found that, prior to the SRO Rules and Global Settlement, the presence of an underwriting business with the subject company implied a 50% increase in the odds that a new recommendation would be optimistic.[55] However, the study found that the effect has "largely disappeared" after the new regulations took effect.[56]

The Kadan Study similarly found that regulatory measures enacted to separate research from investment banking have resulted in less optimistic research by analysts whose firms had or sought investment banking business with companies the analyst covered (an "affiliated" analyst). The study found that prior to the Global Settlement, affiliated analysts generated more optimistic recommendations and long-term growth forecasts than their unaffiliated counterparts; however, those differences have now been eliminated.[57] Consistent with the Barber and Madureira studies, the Kadan Study found a decrease in the percentage of affiliated analysts' buy recommendations and an increase in their hold and sell recommendations following the Global Settlement.[58] The authors found a similar but less dramatic shift in ratings distribution with respect to unaffiliated analyst recommendations.[59]

In a subsequent paper combining the Madureira and Kadan studies, the authors explained that analysts changed their behavior in an asymmetric way after adoption of the SRO Rules.[60]

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51 Madureira Study at 17-18.

52 *Id.* at 18.

53 *Id.*

54 *Id.* at 21.

55 *Id.* at 4.

56 *Id.*

57 Kadan Study at 4, 26.

58 *Id.* at 21-22, Table 6.

59 *Id.* at 22.

60 Ohad Kadan, Leonardo Madureira, Rong Wang & Tzachi Zach, *Conflicts of Interest and Stock Recommendations - The Effects of the Global Settlement and Recent Regulations*, at 25 (July 2005) (Working paper, John M. Olin School of Business, Washington University and Weatherhead School of Management, Case Western Reserve University).

Analysts now behave similarly when deciding whether to post an optimistic recommendation, and the likelihood of receiving an optimistic recommendation no longer depends on whether the analyst's firm participated in an equity offering for the subject company.[61] However, affiliated analysts are still reluctant to issue pessimistic recommendations for companies that have had a recent equity offering.[62]

One recent academic study found lesser changes in ratings distributions since the Global Settlement.[63] The author analyzed data for each of the ten Global Settlement firms and found that prior to the settlement, between 28.4% (in 2002) to 39.8% (in 2000) of recommendations across the ten firms carried a firm's highest rating. After the settlement, top recommendations comprised between 31.8% (in 2003) and 39% (in 2004) of all recommendations.[64] The percentage of the most negative recommendations decrease from a pre-settlement range of 24.1% (in 2000) to 32.4% (in 2002) to a post-settlement range of 18.8% (in 2003) and 12.8% (in 2004).[65] The author notes that the numbers may be explained by factors other than bias, such as analysts' accurate and unbiased expectation of investment value in the post-settlement period or the fact that analysts may intentionally have skewed their coverage post-settlement to stocks that they expect will outperform the market.[66]

A number of news articles buttress the conclusion that sell-side analysts are less biased after implementation of the SRO Rules and/or the Global Settlement and now are more prone to issue downgrades and sell recommendations. According to a recent article, "sell-side analysts do appear to be more discerning," noting that sell ratings, which accounted for less than 2% of the ratings published on Wall Street in 2002, were up to between 10% and 15% of the ratings at all major brokerages.[67] Another article reported in August 2003 that sell recommendations represented 15-25% of overall opinions, attributing the trend at least in part to adoption of the SRO Rules.[68] According to *The Wall Street Journal*, at one point in 2000, 95% of the stocks in the S&P 500 had no sells at all and no stock had more than one sell rating; today, only 38% are without sell recommendations, 62% have at least one sell and 9% have five sells or more.[69]

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61 *Id.*

62 *Id.* at 25-26.

63 Leslie Boni, *Analyzing the Analysts After the Global Settlement*, at 5 (Aug. 25, 2005) (Working paper, University of New Mexico) (the "Boni Study").

64 *Id.* at 13.

65 *Id.*

66 *Id.* at 14.

67 Nat Worden, *Mixed Returns on Spitzer Research Settlement*, The Street.com, Apr. 22, 2005, http://www.thestreet.com/markets/natworden/10218183.html. *See also* Dan Ackman, *Wall Street Tries To Say 'Sell'*, Forbes.com, June 20, 2003, http://www.forbes.com/2003/06/20/cx_da_0620topnews_print.html (in June 2003, 43% of recommendations were buy, 46.6% were hold and 10.5% were sell, compared with June 2000, when 74.6% of all recommendations were buy and only 0.7% were sell); *Facts Without Fiction*, Crystal Research Assoc., LLC, Issue 3 (Winter 2005); *Analysts Say 'Sell' A Lot More Often*, Reuters News Service, May 18, 2003, http://www.chron.com/disp/story.mpl/business/mym/1914061.html.

68 Andrew Leckey, *Dumping Stock Shouldn't Be Such A Hard Sell*, Chicago Tribune, Aug. 12, 2003, at C4.

69 E.S. Browning, *Analysts Keep Misfiring With 'Sell' Ratings*, Wall St. J., Apr. 11, 2005, at C1.

Some news stories also report that bias still exists, particularly at larger firms with investment banking businesses.[70] According to one report, the top ten Wall Street firms give a higher percentage of buy ratings – 46% versus 40% – to those companies with which they do investment banking business.[71] Another article reports that many firms still maintain only 0-6% sell recommendations.[72] Finally, one news article reports that small firms may be slightly more likely to issue buy recommendations than the Global Settlement firms.[73]

(b) Correlation between recommendations and earnings forecasts

A recent academic study attempted to measure research bias after the SRO Rules by examining the relationship between earnings forecasts and recommendation profitability across three groups of sell-side analysts: "top-tier" analysts at the top investment banks, other investment bank analysts and non-investment bank analysts.[74] Absent bias, the authors believe that there should be a strong correlation between accuracy in predicting earnings and profiting from following analyst recommendations since most recommendations are derived from earnings analysis. The authors further posit that bias is more likely to appear in recommendations than earnings forecasts because analysts' reputations are tied more closely to accurately predicting earnings.

During the 1993 to 2000 period, the study found a "positive and significant association" between forecast accuracy and recommendation profitability for non-investment bank analysts, but no such relation for top-tier analysts and other investment bank analysts.[75] The authors suggest that this finding demonstrates that before the SRO Rules, the presence of conflicts at investment banks resulted in overly optimistic recommendations disconnected from earnings forecasts.[76] However, in the period following the Global Settlement and implementation of the SRO Rules, the study found such positive correlation between earnings forecast accuracy and recommendation profitability for analysts employed by top-tier investment banks, suggesting that "the increased awareness of the conflicts of interest and the regulatory changes might have had their desired effect."[77]

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70 *See, e.g.*, Amey Stone, *Yes, Wall Street Research Is Better*, BusinessWeek Online, June 28, 2004, http://businessweek.com/bwdaily/dnflash/jun2004/nf20040628_1253_db014.htm ("some might conclude that bias still exists").

71 *Id.*

72 Joseph McCafferty, *Reform of Sell-side Research is Creating A Variety of New Headaches for Corporations*, CFO Magazine, May 2003. *See also* Leckey, *supra* note 68.

73 Susanne Craig, *Research Rules Trickle Down To Small Firms*, Wall St. J. Online, Jan. 18, 2004, http://online.wsj.com/article/o,,SB107446466140004574,00.html.

74 Yonca Ertimur, Jayanthi Sunder & Shyam V. Sunder, *Measure for Measure: An Examination of the Association between Forecast Accuracy and Recommendation Profitability of Sell-Side Analyst* (Mar. 2005) (Working paper, Graduate School of Business, Stanford University and Kellogg School of Management, Northwestern University) (the "Ertimur Study").

75 *Id.* at 4.

76 *Id.* at 2.

77 *Id.* at 19.

Research Is More Reliable, Accurate And Informative For Investors

Recent studies and a number of news articles suggest that the quality of research and value to investors has improved since adoption of the SRO Rules. For example, one article reports that the "most important change for the better is in the quality of analysis . . . written commentary in stock reports is more independent, more thought-provoking, and better represents the upside and downside potential for a stock than the bubble era's much-hyped reports."[78] And in numerous interviews, portfolio managers attest to the improvement.[79] Another article reports that "the investment community is now benefiting from more diverse research strategies, with access to reports that are less restricted and more user-friendly."[80] As discussed in more detail below, research has also become more trusted by the market and more reliable and meaningful for investors.

(a) Ratings reflect their plain meanings

The SRO Rules require that ratings be consistent with their plain meanings, and several studies have concluded that ratings indeed are now truer and therefore more predictive for investors. For example, the Kadan Study found that following the Global Settlement, the price reaction in the market to buy recommendations has been "significantly more positive" and the price reaction to hold recommendations has been "significantly less negative."[81] In other words, the market now accepts ratings at face value and stocks trade consistent with the plain meanings of the recommendations. According to the Kadan Study, these results suggest that buy and hold recommendations are now "more informative to investors."[82] As for sell recommendations, the Kadan Study found more mixed results.[83] The Madureira Study also found that firms now generally seem to "mean what they say" when issuing hold and sell recommendations,[84] concluding that "brokerage houses no longer are disguising pessimistic recommendations as neutral ratings."[85] In contrast, before the SRO Rules and Global Settlement, a hold rating often was tantamount to a sell recommendation,[86] which would generate far greater negative price reaction in the market than the author has found since implementation of the regulations.

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78 Stone, *supra* note 70 (in the "bad old days," research on the same company was "often barely distinguishable" among research firms).

79 *Id. See also* McCafferty, *supra* note 72 (most experts expect analysts to "dig deeper into the companies they cover").

80 *Facts Without Fiction*, *supra* note 67, at 1 (noting that research is now "a competitive marketplace of versatile and diverse research providers"). *See also SIA Research Management Conference: Reflections on Two Years Since the Global Settlement*, SIA Research Reports, Vol. VI, No. 9 (Sept. 30, 2005) ("panelists agreed that there is a far greater variety of research products and services available today").

81 Kadan Study at 20.

82 *Id.*

83 *Id.*

84 Madureira Study at 3, 25-26.

85 *Id.* at 25, 26. The study did, however, find some negative market reactions to hold recommendations issued by non-settling firms.

86 Madureira Study at 2.

However, one recent academic study has found that investors are less responsive to analyst recommendations. The Boni Study found that market participants on average respond less to recommendation changes made by the ten settlement firms after the Global Settlement (*i.e.*, stock prices increase less on upgrades and decrease less on downgrades than they did prior to the Global Settlement).[87] The author notes that it is possible that retail investors react to analyst recommendations as they did before the settlement but institutional investors respond less.[88]

(b) Recommendations may be more accurate and predictive of investment profitability

Reports suggest that research has become more accurate following implementation of the SRO Rules and the Global Settlement, which served "as a wake-up call for many sell-side research professionals . . . . As a result, broker/dealers and investment banks are now paying much more attention to the accuracy of their research recommendations."[89]

And there is evidence that investors who follow recommendations may be seeing improved returns. For example, the Barber Study concluded that the disclosure requirements in the SRO Rules provide investors with helpful information to assess the value of a research analyst's recommendation and to predict profitability by investing consistent with those recommendations. The authors found that prior to the implementation of the SRO Rules, upgrades from brokers with the highest percentage of pessimistic ratings outperformed by an average of 50 basis points those brokers that tended to have a more optimistic ratings distribution.[90] The obverse also held true: downgrades to hold or sell from the more optimistic brokers significantly outperformed investments in stocks downgraded by brokers with more pessimistic ratings distributions.[91] The authors note that these differences have effectively evaporated after implementation of the SRO Rules, leading to their conclusion that the ratings distribution disclosure requirement has made research more transparent for investors.[92]

According to Starmine, a firm that rates analyst performance, following analysts' advice would have had a slightly negative impact on portfolios on average in 2002; however, in 2003, it would have added 2.2 percentage points to returns.[93] In 2004, analysts outperformed benchmarks by

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87 Boni Study at 19.

88 *Id.* However, this seems inconsistent with the author's observation that according to polls, most institutional investors said that they largely ignored analysts' recommendation ratings prior to the Global Settlement. *Id.* at 3.

89 Integrity Research Assoc. & Meghan Leerskov, *Gauging The Independent Edge*, Buyside, June 2004, at 61, 66. *See also* Stone, *supra* note 70 (quoting a senior analyst at First Call as saying that research over the prior two years "has become more objective, more original, and more accurate").

90 Barber Study at 6, 31.

91 *Id.*

92 *Id. at 36.*

93 Stone, *supra* note 70. *See also* Daniel Gross, *The Best Stock Tips in Town - Buy When These Guys Say Buy, Not When Those Guys Say Buy*, Aug. 4, 2004, http://slate.msn.com/id/2104760 (according to a Smith Barney study, investors who heeded consensus advice from mid-2001 through mid-2003 would have lost money, including a loss of more than 35% in the fourth quarter of 2001; however, there were two straight

1.3 percentage points.[94] In addition, by 2005, five of the top ten best-performing research shops were sell-side brokerages, as opposed to two years ago, when independent analysts occupied nine of the top ten spots.[95]

On the other hand, the Boni Study found very little change in the performance of analyst recommendations. The Boni Study found that stocks that received the strongest recommendations of settling firm analysts outperformed the S&P 500 index both before and after the Global Settlement.[96] The study found the same to be true for stocks that received the analysts' worst ratings and in fact, more often than not, such stocks outperformed those stocks that received analysts' strongest recommendations both before and after the Global Settlement.[97] In discussing these findings, the author noted that both before and after the Global Settlement, recommended stocks that outperformed the S&P 500 index did so at least in part because they are riskier investments on average.[98]

Some news reports also have suggested that the accuracy of research has not improved appreciably as a result of the SRO Rules. An analysis performed for *The Wall Street Journal* indicates that analysts are doing no better a job of picking stocks than they were before the research scandals.[99] The article reported that since 2000, "even though Wall Street supposedly has become more discriminating," stocks with large proportions of sell ratings are performing better than those with buy and hold ratings.[100] In 2003-2004, stocks with the most sell ratings rose 36% on average, while those with the most buys rose just over 25%.[101]

Research Ratings Have Been Simplified

The SRO Rules also have led to widespread adoption of simplified ratings systems. As the Madureira Study explained, the new ratings systems are simplified in terms of the number of ratings categories and the meaning among analysts is "very uniform."[102] Eight of the ten Global Settlement firms adopted new ratings system in 2002, and many of the next largest brokerage

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quarters of positive performance in the second half of 2003); Melissa Lee & John Metaxas, *Change Comes Slowly To Wall St. Research*, Apr. 26, 2004, http://msnbc.msn.com/id/4816690/print/1/displaymode/1098.

94 Matt Krantz, *Analysts Deliver Better Advice*, Feb. 9, 2005, http://www.investars.com/articles20050209.asp; Jane J. Kim, *Stock Research Gets More Reliable*, Wall St. J., June 7, 2005, at D1.

95 Worden, *supra* note 67. *See also* Kim, *supra* note 94 (some of the brokerage firms that were part of the Global Settlement have climbed higher in rankings of the best-performing research shops).

96 Boni Study at 5.

97 *Id.*

98 *Id.* at 5-6.

99 Browning, *supra* note 69.

100 *Id.*

101 *Id.*

102 Madureira Study at 13. The author noted that the changes in ratings systems came about in response to the SRO Rules, which "express[ed] the regulators' concern about ratings systems that were loosely defined and perhaps not properly understood by the research's clients." *Id.* at 11.

houses began to adopt new systems around the same time.[103] Only one of the new ratings systems was adopted before the SRO Rules became effective in July 2002, and many came on line contemporaneous with the September 9, 2002 implementation date of the SRO Rules ratings distribution requirements.[104] Most large brokerage houses now use a three-tier ratings system, and every new ratings system adopted after 2001 is a three-tier system.[105]

Some news articles indicate that research can still be confusing for investors, since not all brokerages have adopted new ratings systems, and there is no mandated or accepted uniform ratings system for those that have them.[106]

Conflicts Of Interest Have Been Reduced But Not Eliminated

Numerous articles provide anecdotal evidence that the conflicts of interest arising from the close relationship of research and investment banking have been mitigated following implementation of the SRO Rules and Global Settlement. For example, one investment bank had to drop out of a large IPO in May 2005 after its top media research analyst told the firm's senior bankers that they were overpricing the shares.[107] In another example, analysts at two firms that launched a recent hot IPO began coverage on the stock with an "underperform" rating.[108]

However, a December 2004 *Newsweek* article reports that despite the regulatory changes and Global Settlement, the "big financial firms are still rife with conflicts that put their own interests, and those of big banking clients, ahead of everyone else's."[109] The article cites as evidence of such conflicts the fact that analysts can still meet with executives around the time they are considering which investment bankers to hire and investment banking fees continue to flow into a pool of money used to pay analysts.[110] Another article reports that "at some firms, banking and research were still a little too cozy" and companies looking for underwriters "still want to be sure they'll get positive research coverage once their stock is issued."[111] According to the article,

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103 *Id.* at 11.

104 *Id.* at 13; *see also* Barber Study at 14.

105 Madureira at 13. The result of the change in ratings system was that many outstanding recommendations were downgraded. *Id.* at 14. More than 90% of the stocks newly rated pessimistic were rated at least neutral under the old system, and more than 40% of the stocks newly rated neutral were rated at least buy/strong buy under the old system. *Id.*

106 Susanne Craig & Ann Davis, *Analyze This: Research Is Fuzzier Than Ever*, Wall St. J., Apr. 26, 2004 at C1 (ratings are not comparable across firms because the SRO rules do not require a uniform methodology).

107 Andrew Ross Sorkin & Jeff Leeds, *Has Wall Street Changed Its Tune?*, June 19, 2005, http://boycott-riaa.com/article/17252 (stating that "[t]hroughout Wall Street, research analysts at major investment banks are increasingly showing a new sense of independence"). *See also* Joseph Nocera, *Wall Street on the Run*, June 14, 2004, http://www.pbs.org/wsw/news/fortunearticle_20040614_02.html (reporting that there have been "plenty of stories about analysts, freed from pressure from bankers, who vetoed important underwriting deals").

108 Matt Krantz, *IPO underwriters' ratings get tougher, Baidu.com hit*, USA Today, Sept. 14, 2005.

109 Charles Gasparino, *The Street's Dark Side*, Newsweek (U.S. Edition), Dec. 20, 2004, at 40.

110 *Id.*

111 Nocera, *supra* note 107.

research continues to be used to attract banking business.[112] Another article suggests that "change has come more slowly to smaller securities firms."[113] The article tells the story of one analyst who, after adoption of the SRO Rules, received a voice mail from a banker scolding him for a negative report and threatening that the analyst's compensation is still determined by investment banking revenue.[114]

A Harvard Business School professor who has studied research analysts said in an interview that even where research is separated from investment banking, conflicts of interest persist.[115] These conflicts arise because (1) sell-side analysts have incentives to hype stocks to generate trading business through large institutional investors who may be clients of the brokerage firm, and (2) once a sell-side analyst has prompted an institutional client to take a large position in a stock recommended by the analyst, the analyst faces a disincentive to downgrade the stock and thereby impact the value of the client's position.[116]

In addition, while the SRO Rules may have lessened the internal pressure on analysts, there have been a number of reports indicating that analysts are coming under external pressure – retaliation by issuers against analysts who have downgraded their stock.[117] Some say that the regulatory reforms splitting investment banking from stock research could shift the source of pressures from investment banking to the issuers.[118]

Research Coverage Has Diminished

Several press accounts report that the number of companies covered by research analysts has decreased since the implementation of the Global Settlement and SRO Rules. A recent report says that since 2002, 691 companies have lost analyst coverage altogether and 99% of the

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112 *Id. See also Timing of Stock Issuance Raises Eyebrows After Upgrade*, Wall St. J., Sept. 14, 2005, at C1 (within two days after research analyst upgraded stock, employing firm won the right to lead a stock issue for the company).

113 Craig, *supra* note 73.

114 *Id.*

115 Ann Cullen, *The Bias of Wall Street Analysts*, Oct. 18, 2004, http://hbswk.hbs.edu/tools/print_item.jhtml?id=4430&t=enterpreneurship.

116 *Id.*

117 Gretchen Morgenson, *You'll Never Do Research in This Town Again*, N.Y. Times, July 31, 2005, at BU 1 (fear of retaliation from the companies they follow may explain analysts' unreasoned optimism); Adrienne Baker, *Leader: Spitzer's Next Challlenge?* Apr. 2005, http://ironthenet.com/feature.asp?current=1&articleID=4048 (in a survey of 732 analysts, 40% said they felt shut out by a firm after they downgraded its equity and another 6% said that companies had threatened to suspend banking relationships following a downgrade); Melissa Lee & John Metexas, *When Companies Behave Badly To Analysts*, Apr. 29, 2004, http://msnbc.msn.com/id/4816980/print/1/displaymode/1098/; Richard J. Wayman, *Are Analysts 'Too' Independent? Apparently The French Think So*, Jan. 30, 2004, http://www.researchstock.com/cgi-bin/rview.cgi?c=bulls&rsrc=RC-20040130-F; Deborah Solomon & Robert Frank, *'You Don't Like Our Stock? You Are Off The List'*, Wall St. J., June 19, 2003, at C1; *Corporate Retaliation on Analysts*, Apr. 8, 2003, http://www.ironthenet.com/static/disclosure/USCanada/CorporateRetaliation0403.htm.

118 Solomon & Frank, *supra* note 117.

companies that have lost coverage are smaller companies with a stock market value of less than $1 billion.[119] According to Reuters Research, as of January 2004, 666 companies in its database of 4,075 had been "orphaned" by sell-side analysts, while in 2002, only 85 companies were left without analyst coverage.[120] Of the companies that have not been orphaned, 380 are down to a pair of analysts, while 473 companies have just one.[121] Similarly, a recent academic study has found that the number of stocks covered by the ten Global Settlement firms has dropped an average of 14% relative to 2000 and 20% relative to 2001.[122] However, three of the ten firms show little change or even an increase in the number of companies they covered pre- and post-settlement.[123]

On the other hand, at least one article indicates that there has been no loss in coverage. In June 2004, First Call, which monitors and distributes analysts' reports, said that as much research coverage is being generated and that 4,158 companies were being covered, down from 4,257 in June 2002.[124]

To the extent that coverage has diminished, some of the cutback has been attributed to the new regulatory environment, while others say that it is not clear that the new regulations are wholly to blame,[125] and some blame "long-term economic forces."[126]

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119 Susanne Craig, *Firm To Research Stock 'Orphans'*, Wall St. J., June 7, 2005, at C3. *See also* SIA Research Reports, Vol. VI, No. 9, at 12 ("Panelists also agreed that there appears to be a decline in the coverage of smaller stocks (those with market capitalization lower than $1 billion), which has a negative impact on capital formation."); Robert Scott Martin, *Issuer-Paid Research Comes of Age*, Buyside (2005), http://www.buyside.com/archives/2005/0501/0501fidea.asp (64% of all publicly traded companies do not have sell-side coverage and if over-the-counter stocks are included, the number jumps to 80%); Ritu Kalra, *Paid-For Research Scores With Investors*, Reuters, July 17, 2004, http://www.boston.com/business/articles/2004/07/17/paid_for_research_scores_with_investors/ (for companies whose market capitalization is less than $500 million, overall coverage is down by more than 35% since 2001 and nearly 60% of all publicly traded companies in the U.S. get no coverage at all); Lee & Metaxas, *supra* note 93 (Morgan Stanley cut stocks covered in North America by 26% and Merrill by 30%); Landon Thomas Jr., *Changed Smith Barney Is Thin on Analysts*, N.Y. Times, June 13, 2003, at C1 (Smith Barney discontinued coverage – at least temporarily – of close to 250 companies); McCafferty, *supra* note 72 (in 1998, 6,100 companies drew coverage from at least one analyst, but by May 2003, that number was down 30%, to 4,300).

120 Marie Leone, *The Flight of The Sell-Side Analyst*, July 8, 2004, http://www.cfo.com/printable/article.cfm/3015019?f=options.

121 *Id.*

122 Boni Study at 4.

123 *Id.* at 12.

124 Stone, *supra* note 70 (noting that this decline may reflect the absence of IPOs and merger activity rather than research changes).

125 Rachel McTague, *Goldschmid Concerned About Reduction In Broker-Dealers' Budgets For Research*, BNA, Inc., Sept. 21, 2004.

126 Martin, *supra* note 119.

Research Industry Has Changed

There have been many reports that the "old research model is dead,"[127] although little consensus has emerged as to the new models. Summarized below are some additional reported changes in the research industry, not discussed elsewhere in this section, since the implementation of the SRO Rules and Global Settlement.

- Institutional investors are diverting equity commission dollars away from Wall Street's traditional research to securing access to analysts and company management.[128]

- There has been a decrease in sell-side research staff and budgets in light of the separation of research from investment banking revenue.[129]

- Sell-side analysts are migrating to the buy-side/money management firms.[130]

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127 Nocera, *supra* note 107. *See also* Kyle L. Brandon, *Update on Research Analysts Related Issues*, SIA Research Reports, Vol. VI, No. 5, at 8 (May 27, 2005) (to date, "sell-side firms have not come up with an answer to the question 'what is the new business model after the global settlement?'").

128 James Langton, *Study Shows Institutions Moving Away From Wall St. Research*, July 13, 2005, http://www.investmentexecutive.com/client/en/News/ImprimerDetail.asp?Id=29645&IdSe.

129 SIA Research Reports, Vol. VI, No. 9, at 11 (one panelist estimated that research lost half of its funding with the loss of investment banking revenues at the same time that commission revenue fell by 30%); Mara Der Hovanesian & Amy Borrus, *Can The Street Make Research Pay? In The Eliot Spitzer Era, It's Looking More and More Like An Expensive Luxury*, Jan. 31, 2005, http://www.capco.com/print.aspx?page=%2fpress.aspx%3fid%3d536 (research budgets at the seven biggest U.S. securities firms have fallen by more than 40% since 2000); McTague, *supra* note 125 (research budgets are down by as much as one-third at some broker-dealer firms); Leone, *supra* note 120 (the number of sell-side analysts has decreased by 15-20% over the last few years); Adam Piore, *Can Investors Get An Honest Stock Tip On (Or Off) Wall Street?*, Newsweek Int'l, Mar. 2004, http://www.msnbc.msn.com/id/4468645 (HSBC announced that it would stop picking stocks altogether, declaring the old research model "broken"); Ann Davis, *Increasingly, Stock Research Serves The Pros, Not 'Little Guy'*, Wall St. J., Mar. 5, 2004, at A1; Daniel Dunaief, *Analysts Abandon Wall St*., N.Y. Daily News, Feb. 24, 2003, http://www.nydailynews.com/business/v-pfriendly/story/61941p-57842c.html (analysts are leaving Wall Street and research has become more bureaucratic in light of new regulations).

130 Greg Crawford, *Money Managers Beefing Up Their Research Staffs; Search For New Ideas Spurs Firms Into Action*, Investment News, June 20, 2005, at 15 (money managers are beefing up their research staffs and between early 2003 and early 2005, the average research staff at U.S. buy-side institutions increased from 9.3 to 10.5 people); Bill Slocum, *Is There A Future For Wall Street Research?*, June 27, 2003, http://www.researchstock.com/cgi-bin/rview.cgi?c=outside&rsrc=RA-20030627-F (in-house equity analysts are being asked to cover more industries and companies than ever before); *Sell Side Gets A Boost*, June 23, 2003, http://www.ironthenet.com/newsarticle.asp?current=1&articleID=2761 (reporting on the increased pressure on buy-side analysts to cover more industries); Paula Lace, *Sell-Side Analysts Make A Break For The Buy Side*, TheStreet.com, Mar. 5, 2003, http://www.thestreet.com/markets/paulalace/10072239.html (the shift to the buy-side could result in making the research industry "even more clubby").

- Many companies are outsourcing research staff to foreign countries, such as India.[131]

- Research is not going to the small investor, whom the regulations were designed to protect, but to institutional investors.[132]

- Issuer-paid research is on the rise as a result of the loss of coverage.[133]

V. REVIEW OF RULE PROVISIONS

A. Analytical Framework for Review

The SRO staffs have conducted a section-by-section review of the SRO Rules to determine whether any additions, deletions or amendments are warranted. In evaluating each provision, the SRO staffs have been guided by several analytical touchstones. First, the SRO staffs looked to the principles that underpinned the original rule development to see if a provision is accomplishing its intended purpose. Second, the SRO staffs reviewed findings from examinations, sweeps and enforcement actions. Third, the SRO staffs considered interpretive requests and member questions. Fourth, the SRO staffs compared the rules to the provisions of the Global Settlement. Fifth, the SRO staffs considered potential gaps or overbreadth in the existing rules. Finally, the SRO staffs considered suggestions from industry groups and members.

B. Section-by-Section Review

Set out below is a discussion of those provisions for which the SRO staffs recommend amendments or further interpretation to the rules. The SRO staffs believe that the other provisions of the SRO Rules are operating effectively and efficiently in achieving their purpose,

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131 Der Hovanesian & Borrus, *supra* note 129; Davis, *supra* note 129; Khozem Merchant & David Wells, *Banks Move Analysts' Work To India*, Financial Times (London), Aug. 20, 2003, at 1.

132 Davis, *supra* note 129 ("the most pioneering, market-moving research is going exclusively to big mutual funds and the private investment pools knows as hedge funds").

133 SIA Research Reports, Vol. VI, No. 9, at 12 (summarizing panel discussion on the issue of "made-to-order" research tailored to meet client requests); Martin, *supra* note 119 (paid-for researchers "have taken strict measures to keep their work as independent as humanly possible"); Kalra, *supra* note 119 (portfolio managers are overcoming their skepticism of issuer-paid research, citing impressive performance and access to information on companies large Wall Street investment banks do not cover); Melissa Lee & John Metaxas, *Beware of Wall St. 'Research For Hire'*, Apr. 28, 2004, http://www.msnbc.msn.com/id/4816907/print/1/displaymode/1098/ (current regulations are not strong enough to protect investors vis-à-vis research for hire and if an analyst is not associated with a broker-dealer, perhaps "caveat emptor" should apply); Ann Davis, *Wall Street, Companies It Covers, Agree on Honesty Policy*, Wall St. J., Mar. 11, 2004, at C1 (discussing best practices guidelines that were a joint effort between the Association for Investment Management and Research and the National Investor Relations Institute); Lynn Cowan, *Research-For-Hire Shops Growing, Seeking Legitimacy*, Wall St. J. Online, July 7, 2003, http://online.wsj.com/article_print/0,,BT_CO_20030707_001632,00.html; Thomas S. Mulligan, *Ignored by Wall St., Firms Turn To Research-For-Hire Outfits; As The Fee-Based Industry Tries To Fill The Gap Left By The Withdrawal of Analyst Coverage, Some Experts Have Reservations*, Los Angeles Times, June 3, 2003; McCafferty, *supra* note 72.

and therefore no changes are recommend to those provisions at this time. In making the recommendations, the SRO staffs are mindful that consideration must be given to the mandates of Sarbanes-Oxley and that, in certain instances, implementing the recommendation may require an exemption from the SEC. The SRO staffs did not attempt to address every interpretive issue that may be outstanding and will continue to entertain interpretive requests on a case-by-case basis and to publish, as warranted, additional joint memoranda setting forth key interpretations.

1. Definitions

Current Rules

The SRO Rules currently include the following defined terms:

"Public appearance" means any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

"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.

"Research analyst" means the associated person who is primarily 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."

Recommended Changes

The SRO staffs recommend several changes to the definitions in NASD Rule 2711 and NYSE Rule 472 to make certain interpretations express in the rule language and to circumscribe the scope of communications subject to the SRO Rules.

"Public Appearance"

The SRO staffs recommend amending the definition of "public appearance" to codify an interpretation consistent with SEC Regulation AC that the term applies only to appearances involving 15 or more separate investors. The SRO staffs further recommend that the definition also codify an exception to that interpretation contained in NASD *Notice to Members* 04-18 and NYSE Information Memo 04-10: that it excludes password-protected Webcasts, conference calls and similar events with 15 or more existing customers, provided that the participants previously received the most current research report or other documentation that includes the disclosures required by the SRO Rules and that the research analyst making the appearance corrects or updates any disclosures that are inaccurate, misleading or no longer applicable.

"Research Report"

The SRO staffs recommend several amendments to the definition of "research report."

First, the SRO staffs suggest codifying the various exceptions to the definition set forth in the two joint interpretive memoranda.[134] These exceptions essentially parallel those in SEC Regulation AC and the Global Settlement and are set forth below:

- reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index;
- reports commenting on economic, political or market (including trading) conditions;
- technical or quantitative analysis concerning the demand and supply for a sector, index or industry based solely on trading volume and price;
- reports that recommend increasing or decreasing holdings in particular industries or sectors or types of securities;
- statistical summaries of multiple companies' financial data and broad-based summaries or listings of recommendations or ratings contained in previously-issued research reports, provided that such summaries or listings do not include any narrative discussion or analysis of individual companies; and
- notices of ratings or price target changes that do not contain any narrative discussion or analysis of the subject company, provided that the member simultaneously directs the readers of the notice as to where to obtain the most recent research report on the subject company that includes the disclosures required by the rule, and the notice does not refer to a research report that contains materially misleading disclosure, such as where the disclosures are outdated or no longer applicable.

In addition, the SRO staffs recommend codifying two other exceptions to the definition of "research report" contained in the March 2004 Joint Memorandum and SEC Regulation AC. These exceptions exclude certain communications even if they include information reasonably sufficient upon which to base an investment decision or a recommendation or rating of individual securities or companies:

- any communication delivered to fewer than 15 persons; and
- periodic reports, solicitations or other communications prepared for current or prospective investment company shareholders (or similar beneficial owners of trusts and limited partnerships) or discretionary investment account clients that discuss individual securities, provided that such communications discuss past performance or the basis for previously made discretionary investment decisions.

Second, the SRO staffs recommend explicitly excluding from the definition sales material regarding registered investment companies and direct participation programs ("DPPs"). Since investment companies and DPPs are "equity securities" as defined in Section 3(a)(11) of the Securities Exchange Act of 1934, related sales material that contains an analysis of those

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134 *See* NASD *Notices to Members* 02-39 (July 2002) and 04-18 (Mar. 2004) and NYSE Information Memos 02-26 (June 26, 2002) and 04-10 (Mar. 9, 2004).

securities and information sufficient upon which to base an investment decision technically is covered by the definition. Yet sales material regarding investment companies is already subject to a separate regulatory regime, including NASD Rule 2210, NYSE Rule 472 and SEC Rule 482, and all advertisements and sales literature regarding investment companies and DPPs must be filed with the NASD Advertising Regulation Department. Moreover, the SRO staffs do not believe that the conflicts underpinning the SRO Rules are manifest to the same extent with respect to research on investment companies and DPPs.

Third, the SRO staffs recommend codifying a longstanding interpretation that communications that constitute prospectuses under the Securities Act of 1933, including free-writing prospectuses as defined under the SEC's recent Securities Offering Reform rules,[135] are not considered "research reports," even if they meet the definitional elements. Such prospectuses facilitate differing purposes from research reports and are subject to a separate comprehensive regulatory scheme.

"Research Analyst"

Several industry members have urged the SROs to amend the definition of "research analyst" to exclude any member personnel who are not principally engaged in the preparation or publication of research reports – a limitation contained in the Global Settlement. The SRO Rules, in accordance with the mandates of Sarbanes-Oxley, are constructed such that the author of a communication that meets the definition of a "research report" is a "research analyst," irrespective of his or her title or primary job. This prevents firms from circumventing the rules by redirecting through other channels, such as registered representatives or traders, potentially biased research that is not subject to the SRO objectivity safeguards.

The SRO staffs believe it is important to maintain such communications as research reports subject to the rules and those principally responsible for their preparation as research analysts. However, the SRO staffs recommend consideration of a limited exemption from the registration requirements for non-research personnel that produce research reports. The SRO staffs believe that the registration and qualification requirements were intended for those individuals whose principal job function is to produce research, while the balance of the SRO Rules are intended to foster objective analysis of equity securities and transparency of certain conflicts and to provide beneficial information to investors.

2. Restrictions on Investment Banking Department Relationship with Research Department

Current Rules

The SRO Rules permit investment banking and other non-research employees, other than legal and compliance personnel, to review a research report before publication only to verify the factual accuracy of information in the report or identify a potential conflict of interest. The rules further require that an authorized legal or compliance official act as intermediary for all such permissible communications.

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[135] Securities Offering Reform, Securities Act Release No. 8591 (July 19, 2005), 70 FR 44722 (Aug. 3, 2005).

Recommended Changes

The SRO staffs recommend eliminating the provision that permits pre-publication review of research by investment banking and other non-research personnel, other than by legal and compliance. The SRO staffs believe that review of facts in a report by investment banking personnel is unnecessary in light of the numerous other sources available to verify factual information and only raises concerns about the objectivity of the report. Such review may invite pressure on a research analyst from investment banking personnel that could be difficult to monitor.[136]

The SRO staffs note that such factual review is not permitted under the terms of the Global Settlement. Moreover, legal and compliance can adequately perform a conflict review without sharing draft research reports with investment banking personnel.

3. Restrictions on Solicitation of Investment Banking Business

Current Rules

The SRO Rules prohibit research analysts from participating in efforts to solicit investment banking business, including pitch meetings with prospective clients.

Recommended Changes

This provision, which mirrors language in the Global Settlement, strikes at a core conflict that can compromise research analysts' objectivity when they and their research are utilized to win business rather than provide dispassioned analysis. While the SRO staffs believe this provision is operating effectively, some members have asked for additional guidance regarding references to research analysts and research in pitch books and related meetings. The SRO staffs note that the SEC has provided interpretive guidance to the parallel provisions of the Global Settlement and concluded that it would be inconsistent with the purpose of the solicitation ban to include in a pitch book or related presentation materials any information regarding an analyst employed by a firm or an analyst's views. The SRO staffs generally agree with that guidance and intend to address this area in more detail in a future interpretive memorandum.

4. Restrictions on Sales and Marketing Activities

Current Rules

The SRO Rules prohibit research analysts from participating in road shows related to investment banking services transactions and from engaging in any communications regarding investment banking services transactions with current or prospective customers in the presence of investment banking personnel or company management. Investment banking personnel also are prohibited from directing a research analyst to engage in sales or marketing efforts or to engage in any communication with a current or prospective customer related to investment banking transactions.

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136 *See, e.g.*, Craig, *supra* note 73.

Recommended Changes

This provision, which is substantially the same as a comparable provision in the Global Settlement, seeks to address potential conflicts of interest during the period that firms market securities offerings for issuers. While the SRO staffs believe this provision is operating effectively, some members have asked for additional guidance on whether research analysts can listen to or view an investment banking or company-sponsored road show or other presentation to investors or the analysts' sales force.

The SRO staffs note that the SEC has provided interpretive guidance on the parallel provision of the Global Settlement and concluded that it would not be inconsistent with this provision to permit research analysts to listen to ("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, investors or the sales force). The SEC has further stated 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-in from the same address as investment banking, investors or the sales force, but may not be in the same room as investment banking, investors or the sales force. The SRO staffs generally agree with that guidance and intend to address this area in more detail in a future interpretive memorandum.

5. Restrictions on Publishing Research Reports and Public Appearances

Current Rules

The SRO Rules set forth, in accordance with the mandates of Sarbanes-Oxley, "quiet periods" during which a member is prohibited from publishing or otherwise distributing a research report and a research analyst is prohibited from making a public appearance. These quiet periods apply in two circumstances: (1) after a public offering of securities and (2) before and after the expiration, waiver or termination of a lock-up agreement entered into by a member with a subject company that restricts the sale of securities by that company or its shareholders.

With respect to the former, the SRO Rules establish different quiet periods depending on whether the offering is an IPO or secondary offering and whether the member acted as manager or co-manager. A member that acted as a manager or co-manager of an IPO may not publish or otherwise distribute research for 40 calendar days following the date of the offering; all other members that participated as an underwriter or dealer in the offering are subject to a 25-day quiet period. A ten-day quiet period applies only to the manager and co-manager of a secondary offering.

The rules contain an exception that permits publication and distribution of research or a public appearance concerning the effects of "significant news or a significant event on the subject company" during the quiet period. The SRO staffs have interpreted this exception to apply only to news or events that have a material impact on, or cause a material change to, a company's operation, earnings or financial condition. Another exception to the secondary offering quiet period permits publication or distribution of research pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities" as defined in SEC Regulation M.

Recommended Changes

The SRO staffs recommend several changes to the quiet periods surrounding public offerings and lock-up expirations. In some cases, the SRO staffs offer alternative recommendations to address these issues.

(a) Quiet periods following public offerings of securities

The SRO staffs recommend unifying the IPO quiet periods for all underwriters and dealers participating in the offering and tying them to the SEC's rules regarding publication and distribution of research. As such, the SRO staffs recommend amending the rules to apply a 25-day quiet period to managers, co-managers, underwriters and dealers that participate in an IPO, unless publication or distribution of the report or the public appearance is permitted by SEC rule or interpretation.

The lengthier quiet period for managers and co-managers was intended to allow other voices to publicly analyze and value a subject company before managers and co-managers – those members vested with the greatest interest in seeing the stock price of the subject company go up – weighed in with their reports and public appearances. At the time this provision was enacted, it had been commonplace for managers and co-managers to initiate coverage with a positive rating on a company they just brought public, irrespective of whether the stock price had already risen well beyond the public offering price.

However, the SRO staffs recently have observed more circumstances where managers and co-managers have been neutral or even negative with their initial post-quiet period report based on price appreciation or other factors. Accordingly, the SRO staffs believe that the objectivity safeguards of the SRO Rules and the certification requirement of SEC Regulation AC have obviated the need for a longer quiet period for managers and co-managers than other underwriters and dealers participating in an IPO. The SRO staffs also believe the change would promote more information flow to investors and consistency with SEC regulations.

For some of the same reasons, the SRO staffs also recommend eliminating the quiet periods following a secondary offering. Coupled with the protections of SEC Regulation AC and other SRO Rule provisions, the SRO staffs believe that repeal of this provision would advance the SEC's purpose in its Securities Offering Reform rules to expand the ability of issuers to release more information regarding their prospects and financial condition, without sacrificing the reliability of the research. Along those lines, the existing SRO Rules already provide exceptions for research reports on issuers with "actively-traded securities" as defined in SEC Regulation M.

(b) Quiet periods around releases of lock-up agreements

The NASD staff recommends eliminating the quiet periods around the expiration, waiver or termination of a lock-up agreement, provided members include an additional statement as part of their SEC Regulation AC certification – or, alternatively, a separate certification – for research issued during such periods. The quiet periods surrounding lock-up releases are intended to prevent abusive "booster shot" reports by members to raise the stock price of a company just before previously locked-up shares become freely saleable into the market by a company or its major shareholders. While the SRO staffs continue to share the concern expressed by the former

Acting Chair of the SEC[137] that these periods pose heightened concerns about biased research, the changes to internal structure of investment banks and the other safeguards imposed by the rules appear to the NASD staff to have addressed these concerns, and have obviated the need for a quiet period that inhibits the flow of information to the marketplace. Moreover, the NASD staff believes that practical limitations inhibit effective administration of the provision. Most notably, the SRO Rules do not require lock-up agreements, and the SROs often have no jurisdiction over parties to them, including the subject company and its non-member shareholders. The SROs therefore cannot always be the arbiter of whether certain facts constitute, for example, a waiver or termination of a lock-up – a significant impediment to the SROs' ability to enforce this provision.

The NASD staff notes that under no circumstances are overly optimistic reports acceptable, whether or not they occur around the expiration of a lock-up. To that end, the SRO Rules require a reasonable basis for any recommendation or price target and the valuation method used to determine a price target, while SEC Regulation AC requires certification that any such recommendation or price target be genuinely held. Accordingly, the NASD staff believes an effective alternative to the quiet periods would be to require that members include under Regulation AC, or separately, an additional certification to having a bona fide reason for issuing research within 15 days before and after a lock-up expiration.

On the other hand, the NYSE staff believes that the quiet period surrounding the expiration, termination or waiver of a lock-up agreement should be maintained but perhaps reduced from the current 15-day period to a five-day period. The NYSE staff believes that the regulatory concerns that precipitated the promulgation of the prohibitions are still present. That is, the NYSE staff is concerned that, absent a quiet period around the release of lock-up agreements, member firms may issue "booster shot" reports that are intended to raise the stock price of a company just before locked-up shares become freely saleable into the market by a company or its major shareholders. The NYSE staff believes that, while the certification requirement of SEC Regulation AC may have obviated the need for a longer quiet period for managers and co-managers than other underwriters and dealers participating in an IPO, it does not support the elimination of quiet periods around the release of lock-up agreements.

With respect to operational issues, the NYSE staff observes that the comments and concerns initially made at the time of the rule proposal have not materialized. In this regard, there have not been instances when the NYSE staff has found co-managers to have inadvertently published research in violation of the quiet periods surrounding the waiver of lock-up agreements granted by lead managers.[138]

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137 Unger Testimony, *supra* note 5, at 229, 235.

138 The NYSE/NASD IPO Advisory Committee made the following recommendations: (1) require prospectuses to include a clear description of lock-up agreements and whether the underwriter expects to grant exceptions relating to hedging or other transactions; and (2) require improved disclosure regarding exemptions by an underwriter to an IPO lock-up agreement, by mandating that underwriters notify issuers prior to granting any exemption to a lock-up, and require issuers to file a current report on Form 8-K at least one business day prior to the time the insider commences the transaction, and also that prior to the transaction, the lead underwriter announces the exemption by broad communications to the investment community through a major news service. *See also* Securities Exchange Act Release No. 50896 (Dec. 20,

Moreover, the NYSE staff notes that while the NYSE may not have jurisdiction over some of the participants to such agreements (*e.g.*, the company and its shareholders), it does retain jurisdiction over its member organizations that can issue research and as such can limit the potential for any untoward conduct by maintaining this prohibition.

Lastly, the NYSE staff notes the recent strength of the IPO market[139] and that such offerings generally contain lock-up agreements. Accordingly, it believes that at this juncture it is appropriate to maintain a form of prohibition absent some compelling empirical data/evidence to the contrary.

(c) Exceptions to quiet periods

As noted above, the rules contain an exception that permits publication and distribution of research or a public appearance concerning the effects of "significant news or a significant event on the subject company" during the quiet period. The SRO staffs have interpreted this exception to apply only to news or events that have a material impact on, or cause a material change to, a company's operations, earnings or financial condition and that generally would trigger the filing requirements of SEC Form 8-K. The SROs have not interpreted the exception to include earnings announcements absent some other significant news or significant event because it was felt that they generally are not a causal event or news items that materially affects a company's operations, earnings or financial condition.

The NYSE staff believes that exceptions to quiet periods should be consistent with SEC requirements for the filing of Forms 8-K. In this regard, Item 2.02 (Results of Operations and Financial Conditions) of Form 8-K requires, in part, a filing of such form if a registrant makes any public announcement or release (including any update of an earlier announcement or release) disclosing material non-public information regarding its results of operations or financial condition. Accordingly, the NYSE staff recommends including an announcement of earnings as an exception to the quiet periods as it will be consistent with SEC requirements and maintain a flow of potentially sensitive information to the market and investors in a timely manner.[140] The NYSE staff also believes that an announcement of a change to earnings will, in all likelihood, be accompanied by an announcement of some type of causal events. Further, earnings announcements and guidance are necessary pipelines of information for research analysts to support the basis of their investment recommendations.

2004), 69 FR 77804 (Dec. 28, 2004) (notice of filing of proposed NYSE Rule 470 and NASD Rule 2712 which would codify, in part, the above recommendations) (SR-NYSE-2004-12 and SR-NASD-2003-140).

139 In 2005, there have been 61 IPOs so far that have listed on the NYSE. In 2004, there were 69 NYSE-listed IPOs. Further, in a recent *Wall Street Journal* article, it was noted that "there are 115 initial public offerings of stock valued at $20.9 billion waiting to price in the U.S. in 2006, according to data from deal tracker Dealogic LLC." Lynn Cowan, *IPO Market Looks Strong in 2006*, Wall St. J., Dec. 19, 2005, at C4.

140 The SEC recognized the importance of timely dissemination of information to the marketplace in its recent amendments to Form 8-K in which it shortened the filing deadline to four business days after the occurrence of an event triggering the disclosure requirements of the form. *See* Securities Act Release No. 8400 and Securities Exchange Act Release No. 49424 (Mar. 16, 2004), 69 FR 15594 (Mar. 25, 2004).

The NASD staff does not believe it is necessary to revise the quiet period exceptions to include any event that triggers the filing of a Form 8-K. The NASD staff continues to believe that earnings announcements are not causal occurrences that, in and of themselves, connote significant news or significant events that materially impact a subject company's financial condition or operations. Moreover, in the NASD staff's experience, abolition of the quiet periods around releases of lock-up agreements would largely obviate the need to expand the "significant news" exception. These issues have arisen mainly because an earnings announcement has occurred or will occur within 15 days of the expiration, waiver or termination of a lock-up agreement. As noted above, the NASD staff further believes that abolition of the quiet periods around releases of lock-up agreements would increase information flow to the marketplace.

6. Restrictions on Personal Trading by Research Analysts

Current Rules

NASD Rule 2711(g) and NYSE Rule 472(e) generally restrict the trading of securities by "research analyst accounts."[141] Specifically, NASD Rule 2711(g) and NYSE Rule 472(e) prohibit any research analyst account from:

- purchasing or receiving any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows;

- purchasing or selling any security issued by a company that the research analyst follows, or any option or derivative of such a security, for a period beginning 30 days before and ending five 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; and

- purchasing or selling any security or option or derivative of such a security in a manner inconsistent with the analyst's most recent recommendation.

The rules include exceptions to these trading restrictions for certain trades that:

- are due to unanticipated significant changes in an analyst's personal financial circumstances;

- occur within the 30-day/five-day trading blackout around the publication of a report if the report is issued due to a significant news event;

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[141] NASD Rule 2711(a)(6) defines the term "research analyst account" to include any account in which a research analyst or member of the analyst's household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. The term does not include a "blind trust" account that is controlled by a person other than the research analyst or household member and neither the analyst nor any household member knows of the account's investments or investment transactions. Although NYSE Rule 472 does not employ the term "research analyst account," the trading restrictions of NYSE Rule 472(e) and NASD Rule 2711(g) are coterminous. *See* NYSE Rule 472.40.

- occur within 30 days after an analyst initiates coverage of a company;

- involve shares of diversified registered investment companies; and

- involve interests in an investment fund over which neither the analyst nor a household member has any investment discretion or control, the research analyst accounts collectively own no more than 1% of the fund's assets, and 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 analyst follows.

NASD Rule 2711(g) and NYSE Rule 472(e) also require legal or compliance personnel to pre-approve all trades of persons who oversee research analysts to the extent such trades involve equity securities of subject companies covered by the analysts they oversee.

Recommended Changes

Members have suggested the SROs make two principal changes to the personal trading restrictions. First, members have urged the SROs to expand the exceptions to the personal trading restrictions to include any investments in funds not controlled by the research analyst or member of his or her household, regardless of whether the fund is registered as an investment company and regardless of its holdings. Second, some members that wish to go beyond the SRO Rules and ban ownership of securities covered by their analysts have asked the SROs to provide a means for those analysts to divest their holdings without violating the blackout period and trading against recommendation prohibitions.

The SRO staffs generally agree with these comments and therefore recommend the following changes to the exceptions to the SRO Rules' personal trading restrictions.

First, the SRO staffs recommend revising the exceptions to the personal trading restrictions for investment funds. The current rules do not apply the personal trading restrictions to investments in diversified registered investment companies and funds that meet certain percentage-of-assets tests. The SRO staffs recommend that the personal trading restrictions instead not apply to investments in any fund so long as neither the analyst nor a member of his or her household is aware of the fund's holdings or transactions other than through periodic shareholder reports and sales material based on such reports, and provided that the research analyst account owns no more than 1% of the assets of the fund.

This would simplify the ability of analysts to invest in mutual funds, variable insurance products and hedge funds that do not disclose their holdings other than through periodic reports or sales material based on such reports. The SRO staffs believe that absent discretion or control of an account or the contemporaneous knowledge of the account's transactions, a minimal investment by a research analyst will not tempt the analyst to compromise research objectivity to benefit the account.

Second, the SRO staffs recommend creating an exemption for firms that voluntarily choose to prohibit their analysts from owning shares of the companies they cover. The exemption would allow such a firm to adopt policies that permit research analysts to divest their holdings in an

orderly and controlled way with the oversight of the firm's legal and compliance personnel. The SRO staffs permitted firms to allow their analysts to divest their holdings in the same manner when the rule first became effective by delaying for a certain time period implementation of the personal trading restrictions for firms that wished to ban ownership. With the recommended change, the rule would allow firms that adopt ownership bans to implement the same divestiture procedures regardless of when they adopted such a policy.

7. Disclosure Requirements

Current Rules

NASD Rule 2711(h) and NYSE Rule 472(k) impose a number of disclosure requirements on member research reports and research analyst public appearances in which the analyst makes a recommendation or offers an opinion concerning an equity security. The rules require specific disclosures of conflicts of interest, including where the member firm, the research analyst or a member of the analyst's household has a financial interest in the subject company's securities or the member or its affiliates have received compensation from the subject company. The rules also require a number of non-conflicts related disclosures in research reports, including the meanings of ratings used in the member's rating system, the distribution of buy, hold, and sell ratings assigned by the member, and a price chart that plots the assignment or changes of the analyst's ratings and price targets for the subject company against the movement of the subject company's stock price over time.

Recommended Changes

The SRO staffs have found that these required disclosures promote transparency and provide important information to enable investors to assess the value of the research in making their investment decision. However, the SRO staffs are concerned that the sheer volume of the disclosures may obscure the overall message that the disclosures are attempting to convey: that the member or research analyst faces conflicts of interest with respect to the subject company. This problem is compounded by the fact that many members include additional disclosures required by other jurisdictions, as well as sometimes lengthy disclaimers for their own purposes. The SRO staffs believe that it would be more effective and useful to investors to know immediately whether the member firm or research analyst producing the research report is conflicted, while providing the reader the means to learn more about these conflicts if he or she chooses to do so.

To accomplish this result, the SRO staffs recommend amending the rules to require that, in lieu of publication in the research report itself, member firms disclose their conflicts of interest related to research reports 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 Web site. A member would then be required to include detailed conflicts information on its Web site. The SRO staffs believe that this disclosure system would be more effective to warn the reader of such conflicts than the current system of disclosing all conflicts in the back of the report.

The SEC has considered using this approach elsewhere to disclose the existence of conflicts of interest to investors. For example, the SRO staffs understand that in its mutual fund point-of-sale disclosure proposal,[142] the SEC staff found that most investors only want to know about whether a conflict exists, rather than receiving quantitative or lengthy disclosure about the precise nature of those conflicts. For that reason, the SEC has proposed requiring a "Yes/No" disclosure of whether a dealer receives revenue sharing or pays differential compensation with respect to the sale of mutual funds. The SEC would require that more detailed disclosure about the nature of any conflicts be provided separately on a mutual fund's Web site.

Similarly, in commenting on the SEC point-of-sale disclosure proposal, the NASD Mutual Fund Task Force recommended Internet delivery of point-of-sale documents and prospectuses, a recommendation that NASD supports.[143] The Task Force argued that Internet delivery would enable investors to obtain the level of disclosure that they wanted in electronic form.

The SRO staffs believe that the research analyst conflict of interest rules similarly lend themselves to a more targeted means of disclosure. The SRO staffs therefore suggest amending the SRO Rules to require conflicts of interest disclosure along the lines of the SEC's point-of-sale proposal and NASD's Internet delivery recommendations for mutual fund related disclosures. This disclosure requirement would ensure that investors obtain prominent disclosure that a research-related conflict exists, and would permit investors to find additional information about the conflict on the member's Web site. It is possible that a similar approach could be used for disclosure of conflicts in public appearances, as long as the existence of such conflicts is clearly communicated.

The SRO staffs generally do not believe that vague, so-called "health warnings" that conflicts of interest "may or may not" exist are useful or effective. In this regard, the SRO Rules would still require disclosure based on actual conflicts of interest, rather than the possibility of such conflicts.

The SRO staffs do not recommend Web site disclosure for the non-conflicts related 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. The SRO staffs believe that these disclosures provide useful information that should be readily available to investors, particularly since they would not be encompassed by the recommended conflict warning on the cover of the report.

Finally, the SRO staffs recommend the inclusion of non-substantive, technical changes to certain disclosure requirements in order either to codify past SRO interpretations of the rules or to clarify the rules' intent. For example, a research report is required to disclose the meanings of ratings used in the member's ratings system only if the report actually includes a rating of the subject company. Similarly, a price chart is not required for reports that do not include a rating or price target. In addition, the SRO staffs recommend including the disclosure requirements for third-party research reports, which are discussed in NASD *Notices to Members* 02-39 (July

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142 Securites Act Release No. 8544 (Feb. 28, 2005), 70 FR 10521 (Mar. 4, 2005).

143 Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 2005), http://www.nasd.com/web/groups/rules_regs/documents/rules_regs/nasdw_013690.pdf.

2002) and 04-18 (Mar. 2004) and NYSE Information Memos 02-26 (June 26, 2002) and 04-10 (Mar. 9, 2004), in the SRO Rules' text.

8. Prohibition on Retaliation Against Research Analysts

Current Rules

The SRO Rules currently prohibit any member and any employee of a member who is involved with the member's investment banking activities from directly or indirectly retaliating against a research analyst as a result of an unfavorable research report or public appearance that may adversely affect the member's current or prospective investment banking relationship with a subject company.

Recommended Changes

The SRO staffs believe that under no circumstances is retaliation appropriate against a research analyst who expresses his or her truly held beliefs about a subject company. As such, the SRO staffs recommend amending this provision to extend the retaliation prohibition to all employees, not just those involved in investment banking activities.

9. Prerequisites for the Research Analyst Qualification Examination

Current Rules

As detailed in Section II, the SRO Rules require an associated person who functions as a research analyst on behalf of a member to register as such and pass the Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption. Prior to taking either the Series 86 or 87, a candidate also must have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative Examination (Series 17), or the Canada Module of Series 7 (Series 37 or 38).

The SRO staffs believe it is important for those functioning as research analysts to be familiar with general industry rules and practices, particularly those of registered representatives, who are a primary source for distributing research. The SRO staffs believe that the topics on the Series 7 and other eligible prerequisite examinations further develop a sensitivity in research analysts to the interests of public customers who are the end users of their work product. The SRO staffs note that a committee of research analysts who were consulted in the development of the Series 86/87 examination program unanimously recommended that research analysts be required to pass the Series 7 in addition to a more job-specific research analyst qualification examination.

Recommended Changes

Several industry members have asked the SROs to consider eliminating the Series 7 or alternative prerequisite exam. These firms argue that research analysts should only be tested on job-specific requirements, and that relevant topics on the Series 7 examination should instead be imported to the Series 86/87 examinations. The SRO staffs recommend considering this suggestion, as well as the possibility of substituting for the Series 7 prerequisite a new Capital Market Professional Examination that is being developed jointly by NASD, the NYSE and

regulators in the United Kingdom. While the content of the latter examination has not yet been precisely determined, it is anticipated that the concepts tested may provide an adequate foundation of general industry rules and practices for research analysts. The SRO staffs will be better situated to evaluate this alternative once the new examination has been fully developed and approved by the SEC.

C. Other Issues

1. Fixed-Income Research

On May 19, 2004, The Bond Market Association ("BMA") issued its "Guiding Principles to Promote the Integrity of Fixed Income Research," which are voluntary principles designed to help firms manage potential conflicts of interest that may arise in their fixed-income research activities.[144] According to the BMA, its Guiding Principles were designed to recognize the significant differences between fixed-income research and equity research, as well as the important differences in research regarding individual fixed-income asset classes.

The SRO staffs do not believe it is appropriate at this time to codify any of these principles or amend the SRO Rules to extend their provisions to fixed-income research. Instead, the SROs are monitoring the extent to which firms have adopted the BMA Guiding Principles and will consider further rulemaking after assessing the effectiveness of voluntary compliance. Meanwhile, the SRO staffs believe that the anti-fraud statutes, as well as existing SRO rules, such as NASD Rule 2110's requirement that members "observe high standards of commercial honor and just and equitable principles of trade" and similar obligations under NYSE Rules 401 and 476(a)(6), can reach any egregious conduct involving fixed-income research.

2. Issuer Retaliation

As noted above, the source of analysts' conflicts was not limited solely to their investment banking relationships, but also included pressure stemming from issuer retaliation. Issuer retaliation can consist of limiting an analyst's access to company management or participation in conference calls, and interfering with other company relationships (such as by prohibiting the analyst's firm from managing an issuer's pension plan). The SRO Rules have insulated analysts from internal pressures from investment banking personnel by prohibiting retaliation by a member against a research analyst for issuing an unfavorable research report that adversely affects a firm's investment banking relationship with an issuer. The prohibition against investment banking personnel's supervising or controlling analysts or participating in the determination of analyst compensation also protects the analyst from retaliation by the investment banking department.

Protection from retaliation by an issuer rather than the investment bank is a more difficult problem to solve. The issue could be addressed through listing standards. However, the NYSE does not believe amendments to its listing standards and its limited ability to enforce such standards by delisting is practicable. In this regard, issuer retaliation, unlike other prohibited

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144 *See* Guiding Principles To Promote Integrity of Fixed Income Research, May 2004, http://www.bondmarkets.com/assets/files/Guiding_Principles_for_Research.pdf.

firm conduct, is very fact specific, qualitative rather than quantitative in nature and difficult to evaluate and discern with absolute certainty.

Accordingly, the NYSE would like to see the practical impact of the CFA/NIRI "Best Practice Guidelines Governing Analyst/Corporate Issuer Relations" which it has endorsed and communicated to its listed companies.[145] It will continue to monitor the impact of such Best Practices and will continue to engage the SEC in dialogue to explore other practical ways to address this issue.

3. Foreign Regulatory Initiatives

In addition to the SROs, regulators in such jurisdictions as the United Kingdom,[146] Canada,[147] Japan,[148] and Australia[149] have implemented or proposed research analyst conflict of interest rules in some form. Organizations such as the International Organization of Securities Commissions ("IOSCO") also have issued guidelines and best practices for their members.[150] And the European Union Forum Group ("EU") released a set of recommendations involving research analyst conflicts to be included in a directive targeting market abuse and promoting uniform regulations among the different European Union securities markets.[151]

These regulatory models share a common goal of reducing bias in the production and dissemination of research. At the same time, the various initiatives by these regulatory groups demonstrate that there are a number of approaches to eliminating research analyst conflicts: some organizations, like IOSCO and the EU, recommend best practices but do not impose

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145 The NYSE recently issued a letter to its listed companies encouraging them to consider implementing CFA/NIRI Best Practice Guidelines Governing the Relationship between Analysts and Corporate Issuers. *See* letter dated October 11, 2005 from Richard G. Ketchum, Chief Regulatory Officer, NYSE, to Exchange Listed Companies.

146 Regulations by the Financial Services Authority, "Discussion Paper No. 15" and "Consultation Paper 171," July 2002 and December 2003, respectively.

147 Report issued by Securities Industry Committee on Analyst Standards, which was established by the Toronto Stock Exchange, the Investment Dealers Association ("IDA") and the Canadian Venture Exchange. The report, entitled "Setting Analyst Standards: Recommendations for the Supervision and Practice of Canadian Securities Industry Analysts" was released in November 2001. IDA "Policy 11, Analyst Standards," was issued in June and December 2002.

148 Japanese Securities Dealers Association, "Rules for Handling Analysts' Reports," January 2002, revised January 2003.

149 Securities Institute of Australia and the Securities and Derivatives Industry Association, "Best Practices Guidelines for Research Integrity," November 2001.

150 IOSCO is an international organization whose members cooperate to promote high standards of regulation to protect investors and ensure that markets are fair, efficient and transparent. In September 2003, the Technical Committee of IOSCO issued a Statement of Principles to guide securities regulators and others in addressing the conflicts of interest securities analysts may face. These principles are combined with certain more specific measures designed to eliminate or manage analysts' conflicts of interest. The Statement of Principles can be found at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf.

151 This group issued a Report and the "Market Abuse Directive" to implement a uniform system of regulation to handle market abuses in the European Union. The Market Abuse Directive was first issued in December 2002.

regulations, while the SRO Rules and rules promulgated by the other regulators take a more prescriptive approach. These diverse regulatory models sometimes result in differing requirements that can pose challenges for firms with global research operations.

The SRO staffs support ongoing discussions with their members and international regulatory groups to promote the most effective and efficient means to manage research analyst conflicts of interest and to ensure reliable and objective research throughout the world.

VI. CONCLUSION

The SRO staffs believe that the SRO Rules have been effective in helping to restore integrity to research by minimizing the influences of investment banking and promoting transparency of other potential conflicts of interest. Evidence also suggests that investors are benefiting from more balanced and accurate research to aid their investment decisions. The SRO staffs believe that certain changes to the SRO Rules would further improve their effectiveness by striking an even better balance between ensuring objective and reliable research on the one hand and permitting the flow of information to investors and minimizing costs and burdens to members on the other.

Rule 472. Communications With The Public

Approval of Communications and Research Reports

(a)(1) Each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member or member organization to customers or the public must be approved in advance by a member, allied member, supervisory analyst, or qualified person designated under the provisions of Rule 342(b)(1).

(2) Research reports must be prepared or approved, in advance, by a supervisory analyst acceptable to the Exchange under the provisions of Rule 344. Where a supervisory analyst does not have technical expertise in a particular product area, the basic analysis contained in such report may be co-approved by a product specialist designated by the organization. In the event that the member organization has no principal or employee qualified with the Exchange to approve such material, it must be approved by a qualified supervisory analyst in another member organization by arrangement between the two member organizations.

Investment Banking, Research Department and Subject Company Relationships and Communications

(b)(1) Research analysts may not be subject to the supervision, or control, of any employee of the member's or member organization's investment banking department and personnel engaged in investment banking activities may not have any influence or control over the compensatory evaluation of a research analyst.

(2) Research reports may not be subject to review or approval prior to publication by Investment Banking personnel or any other employee of the member or member organization who is not directly responsible for investment research ("non-research personnel") other than Legal or Compliance personnel.

(3) Non-research personnel may review research reports prior to publication only to verify the factual accuracy of information in the research report or to identify any potential conflicts of interest that may exist, provided that:

(i) any written communication concerning the content of research reports between non-research personnel and Research personnel must be made either through Legal or Compliance personnel or in a transmission copied to Legal or Compliance personnel; and

(ii) any oral communication concerning the content of research reports between non-research personnel and Research personnel must be documented and made either with Legal or Compliance personnel acting as intermediary or in a conversation conducted in the presence of Legal or Compliance personnel.

(4) A member or member organization may not submit a research report to the subject company prior to publication, except for the review of sections of a draft of the research report solely to verify facts. Members and member organizations may not, under any circumstances, provide the subject

company sections of research reports that include the research summary, the research rating or the price target.

(i) Prior to submitting any sections of the research report to the subject company, the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.

(ii) If after submission to the subject company, the Research Department intends to change the proposed rating or price target, the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change. The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

(iii) The member or member organization may not notify a subject company that a rating will be changed until after the close of trading in the principal market of the subject company one business day prior to the announcement of the change.

(5) A research analyst is prohibited from participating in efforts to solicit investment banking business. This prohibition includes, but is not limited to, participating in meetings to solicit investment banking business (e.g., " pitch" meetings) of prospective investment banking clients, or having other communications with companies for the purpose of soliciting investment banking business. This prohibition shall not apply to any communication between the research analyst, company, and/or non-research personnel, the sole purpose of which is due diligence.

(6)(i) 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 (s) in the presence of investment banking department personnel or company management about an investment banking services transaction.

(ii) 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

(b) directing a research analyst to engage in any communication with a current or prospective customer(s) about an investment banking services transaction.

(iii) Research analyst written and oral communications relating to an investment banking services transaction, with a current or prospective customer(s), or with internal personnel, must be fair, balanced and not misleading, taking into consideration the overall context in which the

communication is made.

Written Procedures

(c) Each member and member organization must establish written procedures reasonably designed to ensure that members, allied members, member organizations and their employees are in compliance with this Rule (see Rule 351(f) and Rule 472(h)(2) for attestations to the Exchange regarding compliance).

Retention of Communications

(d) Communications with the public prepared or issued by a member or member organization must be retained in accordance with Rule 440 ("Books and Records"). The names of the persons who prepared and who reviewed and approved the material must be ascertainable from the retained records and the records retained must be readily available to the Exchange, upon request.

Restrictions on Trading Securities by Associated Persons

(e)(1) No research analyst or household member may purchase or receive an issuer's securities prior to its initial public offering (e.g., so-called pre-IPO shares), if the issuer is principally engaged in the same types of business as companies (or in the same industry classification) which the research analyst usually covers in research reports.

(2) No research analyst or household member may trade in any subject company's securities or derivatives of such securities that the research analyst follows for a period of thirty (30) calendar days prior to and five (5) calendar days after the member's or member organization's publication of research reports concerning such security or a change in rating or price target of a subject company's securities.

(3) No research analyst or household member may effect trades in a manner inconsistent with the research analyst's most current recommendations (i.e., sell securities while maintaining a "buy" or "hold" recommendation, buy securities while maintaining a "sell" recommendation, or effecting a "short sale" in a security while maintaining a "buy" or "hold" recommendation on such security).

(4) Listed below are exceptions to the prohibitions contained in paragraphs (1), (2), and (3) (Each exception granted must be in compliance with policies and procedures adopted by the member or member organization that are reasonably designed to ensure that transactions effected pursuant to these exceptions do not create a conflict of interest between the professional responsibilities and the personal trading activities of the research analyst and/or his or her household member.):

(i) transactions by research analysts and/or household members that have been pre-approved in writing by the Legal or Compliance Department that are made due to an unanticipated significant change in their personal financial circumstances;

(ii) a member or member organization may permit the publication of research reports or permit a change to the rating or price target on a subject company, regardless of whether a research analyst and/or household members traded the subject company's securities or derivatives of such securities, within the thirty (30) calendar day period described in paragraph (e)(2), when the publication of such research reports, or change in such rating or price target is attributable to some significant news or events regarding the subject company, provided that the publication of such research reports, or change in rating or price target on such subject company has been pre-approved in writing by the Legal or Compliance Department;

(iii) sale transactions by a research analyst, who is new to the member or member organization, and/or his or her household members within thirty (30) calendar days of such research analyst's employment with the member or member organization when such research analyst and/or household members had previously purchased such security or derivatives of such security prior to the research analyst's employment with the member or member organization;

(iv) sale transactions by a research analyst and/or household member within thirty (30) calendar days from the date of the member's or member organization's publication of research reports or changes to the rating or price target on a subject company when such research analyst and/or household members had previously purchased the subject company's securities or derivatives of such securities prior to initiation of coverage of the subject company by the research analyst;

(v) transactions in accounts not controlled by the research analyst and for investment funds in which a research analyst or household member has no investment discretion or control, provided the interest of the research analyst or household member in the assets of the fund does not exceed 1% of the fund's assets, and the fund does not invest more than 20% of its assets in securities of issuers principally engaged in the same types of business as companies (or in the same industry classification) which the research analyst usually covers in research reports. If an investment fund distributes securities in kind to a research analyst before the issuer's initial public offering, the research analyst must either divest those securities immediately or refrain from participating in the preparation of research reports concerning that issuer;

(vi) transactions in a registered diversified investment company as defined under Section 5(b)(1) of the Investment Company Act of 1940.

(5) No person who supervises research analysts (e.g., Director of Research), a Supervisory Analyst, or a member of a committee, who has direct influence and/or control with respect to (1) preparing the substance of research reports, or (2) establishing or changing a rating or price target of a subject company's equity securities, may effect trades in securities of companies that are the subject of such research reports, or ratings or price target changes, without the prior approval of the Legal or Compliance personnel of the member or member organization.

(6) Members and member organizations must maintain written records for each transaction and the justification for permitting such transactions for three years following the date the transactions were made pursuant to the exceptions provided for in Rule 472(e)(4)(i)-(iv), and (5).

Restrictions on Member's or Member Organization's Issuance of Research Reports and Participation in Public Appearances

(f)(1) A member or member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member or member organization acted as manager or co-manager of an initial public offering within forty (40) calendar days following the offering date.

(2) A member or member organization may not publish or otherwise distribute research reports regarding an issuer and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance, for which the member or member organization acted as manager or co-manager of a secondary offering within ten (10) calendar days following the offering date. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(3) No member or member organization that 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 may publish or otherwise distribute a research report regarding that issuer and a research analyst may not recommend or offer an opinion on that issuer's securities in a public appearance for twenty-five (25) calendar days following the offering date.

(4) No member or member organization which has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report and a research analyst may not recommend or offer an opinion on an issuer's securities in a public appearance within fifteen (15) days prior to or after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member or member organization has entered into with a subject company and its shareholders that restricts or prohibits the sale of the subject company's or its shareholders' securities after the completion of a securities offering. This prohibition shall not apply to public appearances or research reports published or otherwise distributed under Securities Act Rule 139 regarding issuers whose securities are actively traded, as defined in Securities Exchange Act Rule 101(c)(1) of Regulation M.

(5) A member or member organization may permit exceptions to the prohibitions in paragraphs (f)(1), (2), and (4) (consistent with other securities laws and rules) for research reports that are published or otherwise distributed or recommendations or opinions on an issuer's securities made in a public appearance due to significant news or events, provided that such research reports are pre-approved in writing by the

member's or member organization's Legal or Compliance personnel.

(6) If a member or member organization intends to terminate its research coverage of a subject company, notice of this termination must be made. The member or member organization must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The 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 or member organization to produce a comparable report (e.g., if the research analyst covering the subject company or sector has the left the employ of the member or member organization, or where the member or member organization terminates coverage on the industry or sector). In instances where it is impracticable for the member or member organization to provide a final recommendation or rating, the member or member organization must provide the rationale for the decision to terminate coverage.

Prohibition of Offering Favorable Research for Business

(g)(1) No member or member organization may directly or indirectly offer a favorable research rating or specific price target, or offer to change a rating or price target, to a subject company as consideration or inducement for the receipt of business or for compensation.

(2) No member or member organization and no employee of a member or member organization who is involved with the member's or member organization's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or member organization or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report written or public appearance made by the research analyst that may adversely affect the member's or member organization's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's or member organization's authority to discipline or terminate a research analyst, in accordance with the member's or member organization's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such unfavorable public appearance.

Restrictions on Compensation to Research Analysts

(h)(1) No member or member organization may compensate a research analyst for specific investment banking services transactions. A research analyst may not receive an incentive or bonus that is based on a specific investment banking services transaction. However, a member or member organization is not prohibited from compensating a research analyst based upon such member's or member organization's overall performance (see Rule 472(k)(1)(ii)a.2. for disclosure of such compensation).

(2) The compensation of a research analyst primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee which reports to the Board of Directors or, where the member or member organization has no Board of

Directors, to a senior executive officer of the member or member organization. Such committee may not include representatives from the member's or member organization's Investment Banking Department. The committee must, among other things, consider the following factors, if applicable, when reviewing such research analyst's compensation:

i. The research analyst's individual performance, (e.g., productivity, and quality of research product);

ii. The correlation between the research analyst's recommendations and stock price performance;

iii. The overall ratings received from clients, sales force, and peers independent of the Investment Banking Department, and other independent rating services.

The committee may not consider as a factor in reviewing and approving such research analyst's compensation, his or her contributions to the member's or member organization's investment banking business.

The committee must document the basis upon which such research analyst's compensation was established. The annual attestation required by Rule 351(f) must certify that the committee reviewed and approved the compensation for each research analyst primarily responsible for the preparation of the substance of a research report and has documented the basis upon which such compensation was established.

General Standards for All Communications

(i) No member or member organization shall utilize any communication which contains (i) any untrue statement or omission of a material fact or is otherwise false or misleading; or (ii) promises of specific results, exaggerated or unwarranted claims; or (iii) opinions for which there is no reasonable basis; or (iv) projections or forecasts of future events which are not clearly labeled as forecasts.

Specific Standards for Communications

(j)(1) **Recommendations**

A recommendation (even though not labeled as a recommendation) must have a basis which can be substantiated as reasonable.

When recommending the purchase, sale or switch of specific securities, supporting information must be provided or offered.

The market price at the time the recommendation is made must be indicated.

(2) **Records of Past Performance**

Communications may feature record or statistics which portray the

performance of past recommendations or of actual transactions of the member organization provided that the following conditions are met:

(i) The portrayal is balanced and consists of records or statistics that are confined to a specific "universe" that can be fully isolated and circumscribed and that covers at least the most recent 12-month period.

(ii) The communications include the date and price of each initial recommendation or transaction and the date and price of the recommendation or transaction at the end of the period or when liquidation was suggested or effected, whichever was earlier. Communications may also present summarized or averaged records of statistics or otherwise offer the complete record rather than provide it. This material must include the total number of items recommended or transacted, the number that advanced and declined and an offer to provide the complete record upon request.

(iii) The communications disclose the existence of all relevant costs, including commissions and interest charges or other applicable expenses and, whenever annualized rates of return are used, all material assumptions used in the process of annualization.

(iv) An indication is provided of the general market conditions during the period covered, and any comparison made between such records and statistics and an overall market (e.g., comparison to an index) is valid.

(v) The communications state that the results presented should not and cannot be viewed as an indicator of future performance.

(vi) All the original recommendations or evidence of actual transactions on which the record is based are retained for three years by the organization and made available to the Exchange on request.

(3) **Projections and Predictions**

Any projection or prediction must contain the bases or assumptions upon which they are made and must indicate that the bases or assumptions of the materials upon which such projections and predictions are made are available upon request.

(4) **Comparisons**

Any comparison of one member organization's service, personnel, facilities or charges with those of other firms must be factually supportable.

(5) **Dating Reports**

All communications must be appropriately dated. Any significant information that is not reasonably current (usually more than 6 months old—depending upon the industry and circumstances) must be noted.

(6) **Identification of Sources**

Communications not prepared under the direct supervision of the member organization or its correspondent member organization should show the person (by name and appropriate title) or outside organization which prepared the material.

In distributing communications prepared under the direct supervision of a correspondent member organization, the distributing firm should mention this fact, although it may not be necessary to identify the correspondent by name.

Communications about a corporate issuer which are distributed by a member organization but have been prepared and published by the issuer or for the issuer by a party other than the member organization should clearly identify the preparer and publisher.

(7) **Testimonials**

In testimonials concerning the quality of a firm's investment advice, the following points must be clearly stated in the communication:

(i) The testimonial may not be representative of the experience of other clients.

(ii) The testimonial is not indicative of future performance or success.

(iii) If more than a nominal sum is paid, the fact that it is a paid testimonial must be indicated.

(iv) If the testimonial concerns a technical aspect of investing, the person making the testimonial must have knowledge and experience to form a valid opinion.

Disclosure

(k)(1) Disclosures Required in Research Reports

Disclosure of Member's, Member Organization's, and Research Analyst's Ownership of Securities, Receipt of Compensation, and Subject Company Relationships

The front page of a research report either must include the disclosures required under this Rule or must refer the reader to the page(s) on which each such disclosure is found. Disclosures, and references to disclosures, must be clear, comprehensive, and prominent.

(i) A member or member organization must disclose in research reports:

a. if the member or member organization or its affiliates:

1. has managed or co-managed a public offering of securities for the subject company in the past twelve (12) months;

2. has received compensation for investment banking services from the subject company in the past twelve (12) months; or

3. expects to receive or intends to seek compensation for investment banking services from the subject company in the next three (3) months.

b. if the member or member organization is making a market in the subject company's securities at the time the research report is issued;

c. if, as of the last day of the month immediately preceding the date the publication (or the end of the second most recent month if the publication is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

d. if, as of the last day 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 thirty (30) calendar days after the end of the most recent month):

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of distribution of the research report (In such instances, the member or member organization also must disclose the types of services provided to the subject company. For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);

2. the member or member organization received any compensation for products or services other than for investment banking services from the subject company in the past twelve (12) months.

e. the valuation methods used, and any price objectives must have a reasonable basis and include a discussion of risks;

f. the meanings of all ratings used by the member or member organization in its ratings system (For example, a member or member organization might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next twelve (12)-month period. Definitions of ratings terms also must be consistent with their plain meaning. Therefore, for example, a "hold" rating should not mean or imply that an investor should sell a security.);

g. the percentage of all securities that the member or member organization

recommends an investor "buy," "hold," or "sell." Within each of the three (3) categories, a member or member organization must also disclose the percentage of subject companies that are investment banking services clients of the member or member organization within the previous twelve (12) months (see Rule 472.70 for further information);

h. a chart that depicts the price of the subject company's stock over time and indicates points at which a member or member organization assigned or changed a rating or price target. This provision would apply only to securities that have been assigned a rating for at least one (1) year, and need not extend more than three (3) years prior to the date of the research report. The information in the price chart must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter).

(ii) A member or member organization must include the following disclosures in research reports:

a. if a research analyst received any compensation:

1. from the subject company in the past twelve (12) months;

2. that is based upon (among other factors) the member's or member organization's overall investment banking revenues.

b. if, to the extent the research analyst or an employee of the member or member organization with the ability to influence the substance of a research report, knows:

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of distribution of the research report. In such instances, such member or member organization also must disclose the types of services provided to the subject company (For purposes of paragraph (k)(1) of this Rule, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.). (For purpose of paragraph (k)(1) of this Rule, an employee of a member or member organization 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.);

2. that the member, member organization or any affiliate thereof, received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months.

(iii) A research analyst and a member or member organization must disclose in research reports:

a. if, to the extent the research analyst or member or member organization has reason to know, an affiliate of the member or member organization received any compensation for products or services other than investment banking services from the subject company in the past twelve (12) months;

1. This requirement will be deemed satisfied if such compensation is disclosed in research reports within thirty (30) days after completion of the most recent calendar quarter, provided that the member or member organization has taken steps reasonably designed to identify such compensation during that calendar quarter.

2. The member or member organization and the research analyst will be presumed not to have reason to know whether an affiliate received compensation for other than investment banking services from the subject company in the past twelve (12) months if the member or member organization maintains and enforces policies and procedures reasonably designed to prevent all research analysts and employees of the member or member organization with the ability to influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning such compensation.

3. Paragraph 472(k)(1)(iii)a. shall not apply to any subject company as to which the member or member organization initiated coverage since the beginning of the current calendar quarter.

b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;

c. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;

d. any other actual, material conflict of interest of the research analyst, or member or member organization, of which the research analyst knows, or has reason to know, at the time the research report is published or otherwise distributed.

When a member or member organization publishes or otherwise distributes a research report covering six (6) or more subject companies for purposes of the disclosures required in paragraph (k)(1) of this Rule, such research report 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.

(k)(2) Disclosures Required in Public Appearances

Disclosure of Member's, Member Organization's, and Research Analyst's Ownership of Securities, Receipt of Compensation, and Subject Company Relationships

(i) A research analyst must disclose in public appearances:

a. if, as of the last day of the month before the appearance (or the end of the second most recent month if the appearance is less than ten (10) calendar days after the end of the most recent month), the member or member organization or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. The member or member organization must make the required beneficial ownership computation no later than ten (10) calendar days after the end of the prior month. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

b. if the research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the financial interest, including, without limitation, whether it consists of any option, right, warrant, futures contract, long or short position;

c. if, to the extent the research analyst knows or has reason to know:

1. the subject company currently is a client of the member or member organization or was a client of the member or member organization during the twelve (12)-month period preceding the date of the public appearance by the research analyst. In such instances, the research analyst also must disclose the types of services provided to the subject company (For purposes of this paragraph, the types of services provided to the subject company may be described as investment banking services, non-investment banking-securities related services, and non-securities services.);

2. the member or member organization or any affiliate thereof, received any compensation from the subject company in the past twelve (12) months.

d. any other actual, material conflict of interest of the research analyst, or member or member organization, of which the research analyst knows, or has reason to know, at the time the public appearance is made;

e. if the research analyst or a household member is an officer, director, or advisory board member of the subject company;

f. if the research analyst received any compensation from the subject company in the past twelve (12) months.

(k)(3) Exceptions to the Required Disclosures

(i) A member or member organization or a research analyst will not be required to make a disclosure required by Rule 472(k)(l)(i)a.2. and 3., (k)(1)(i)d.1., (k)(1)(ii)b.1., and (k)(2)(i)c. to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking services transactions of the subject company.

Other Communications Activities

(l) Other communications activities are deemed to include, but are not limited to, conducting interviews with the media, writing books, conducting seminars or lecture courses, writing newspaper or magazine articles, or making radio/TV appearances.

Members and member organizations must establish specific written supervisory procedures applicable to members, allied members, and employees who engage in these types of communications activities. These procedures must include provisions that require prior approval of such activity by a person designated under the provisions of Rule 342(b)(1). These types of activities are subject to the general standards set forth in paragraph (i). In addition, any activity which includes discussion of specific securities is subject to the specific standards in paragraph (j).

Small Firm Exception

(m) The provisions of Rule 472(b)(1), (2) and (3) do not apply to members and member organizations that over the three previous years, on average per year, have participated in ten (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. For purposes of this paragraph, the term "investment banking services transactions" shall include both debt and equity underwritings but not municipal securities underwritings. Members and member organizations that qualify for this exemption must maintain records for three (3) years of any communications that, but for this exemption, would be subject to paragraphs (b)(1), (2), and (3) of this Rule.

• • • ***Supplementary Material:*** ----------

.10 Definitions

(1) **Communication**—The term "Communication" is deemed to include, but is not limited to advertisements, market letters, research reports, sales literature, electronic communications, communications in and with the press and wires and memoranda to branch offices or correspondent firms which are shown or distributed to customers or the public.

(2) **Research Report**— "Research report" is generally defined as a written or electronic communication which includes an analysis of equity securities of individual companies or industries, and provides information reasonably sufficient upon which to base an investment decision.

For purposes of approval by a supervisory analyst pursuant to Rule 472 (a)(2), the term research report includes, but is not limited to, a report which recommends equity securities, derivatives of such securities, including options, debt and other types of fixed income securities, single stock futures products, and other investment vehicles subject to market risk.

(3) **Advertisement**— "Advertisement" is defined to include, but is not limited to, any sales communications that is published, or designed for

use in any print, electronic or other public media such as newspapers, periodicals, magazines, radio, television, telephone recording, web sites, motion pictures, audio or video device, telecommunications device, billboards or signs.

(4) **Market letters**— "Market letters" are defined as, but are not limited to, any written comments on market conditions, individual securities, or other investment vehicles that are not defined as research reports. They also may include "follow-ups" to research reports and articles prepared by members or member organizations which appear in newspapers and periodicals.

(5) **Sales literature**— "Sales literature" is defined as, but is not limited to, written or electronic communications including, but not limited to, telemarketing scripts, performance reports or summaries, form letters, seminar texts, and press releases discussing or promoting the products, services, and facilities offered by a member or member organization, the role of investment in an individual's overall financial plan, or other material calling attention to any other communication.

.20 For purposes of this Rule, "investment banking services" includes, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transaction), or similar investments; or serving as placement agent for the issuer.

.30 For purposes of this Rule, the term "Investment Banking Department" means any department or division of the member or member organization, whether or not identified as such, that performs any investment banking services on behalf of the member or member organization.

.40 For purposes of this Rule, the term "research analyst" includes a member, allied member, associated person or employee of a member or member organization primarily responsible for, and any person who reports directly or indirectly to such research analyst in connection with, the preparation of the substance of a research report whether or not any such person has the job title of "research analyst".

For purposes of this Rule, the term "household member" means any individual whose principal residence is the same as the research analyst's principal residence. Paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v), (k)(1)(iii)b., c., and (k)(2)(i)b. and e. apply to any account in which a research analyst has a financial interest, or over which the research analyst exercises discretion or control, other than an investment company registered under the Investment Company Act of 1940. The trading restrictions applicable to research analysts and household members (i.e., paragraphs (e)(1), (2), (3), (4)(i), (ii), (iii), (iv) and (v); do not apply to a "blind trust" account that is controlled by a person other than the research analyst or research analyst's household member where neither the research analyst nor household member knows of the account's investments or investment transactions.

.50 For purposes of this Rule, the term "public appearance" includes,

without limitation, participation by a research analyst in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or public speaking activity, or the writing of a print media article in which such research analyst makes a recommendation or offers an opinion concerning any equity securities.

.60 For purposes of this Rule, "subject company" is the company whose equity securities are the subject of a research report or a public appearance.

.70 For purposes of Rule 472(k)(1)(i)(h), a member or member organization must determine, based on its own ratings system, into which of the three (3) categories each of their securities ratings utilized falls. This information must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than fifteen (15) calendar days after the most recent calendar quarter). For example, a research report might disclose that the member or member organization has assigned a "buy" rating to 58% of the securities that it follows, a "hold" rating to 15%, and a "sell" rating to 27%.

Rule 472(k)(1)(i)h. requires members or member organizations to disclose the percentage of companies that are investment banking services clients for each of the three (3) ratings categories within the previous twelve (12) months. For example, if twenty (20) of the twenty-five (25) companies to which a member or member organization has assigned a "buy" rating are investment banking clients of the member or member organization, the member or member organization would have to disclose that 80% of the companies that received a "buy" rating are its investment banking clients. Such disclosure must be made for the "buy," "hold" and "sell" ratings categories as appropriate.

.80 For purposes of this Rule, the term "Legal or Compliance Department" also includes, but is not limited to, any department of the member or member organization which performs a similar function.

.90 For purposes of Rule 472(a)(1), a qualified person is one who has passed an examination acceptable to the Exchange.

.100 For purposes of this Rule, the term "initial public offering" refers to the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement.

.110 For purposes of this Rule, a secondary offering shall include a registered follow-on offering by an issuer or a registered offering by persons other than the issuer involving the distribution of securities subject to Regulation M of the Securities Exchange Act of 1934.

.120 For purposes of this Rule, the term "offering date" refers 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.

.130 For purposes of this Rule, the term associated person is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member or member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.

Amended: October 20, 1955, effective November 1, 1955; September 19, 1963, effective October 15, 1963; June 18, 1964; March 26, 1970; February 2, 1977; December 14, 1983; December 31, 1997; March 19, 1990; May 10, 2002 effective July 9, 2002 (NYSE-2002-09); July 29, 2003 (NYSE-2002-49); April 14, 2005 (NYSE-2005-24); April 21, 2005 (NYSE-2004-24).

Rule 472 COMMUNICATIONS WITH THE PUBLIC

(k)(2) Disclosure Required in Public Appearances

/01 Public Appearances – Print Media

When a research analyst recommends securities in a print or broadcast media interview, newspaper article or other type of public medium all of the disclosures required under Rule 472(k)(2) are required to be provided to the media outlet for inclusion in the published interview, article, broadcast, or other medium.

Whenever a research analyst recommends securities in a print media interview, newspaper article prepared under his or her name, or broadcast, a record of such interview, article or broadcast must be made within forty-eight (48) hours of such interview, article or broadcast. Such record must be prepared by the research analyst, Legal or Compliance personnel or Research Department management.

Such record must include, at minimum, the name of the research analyst(s), the name of the publication, the date of the interview, article, or broadcast the name of the interviewer (if applicable), the name(s) of the securities recommended and the specific disclosures provided to the print or broadcast media source and/or interviewer. Such record must be made regardless of whether the media outlet published or broadcast the required disclosures. The research analyst's member or member organization must retain the record of such interview, article, or broadcast and the disclosures made in a manner consistent with Rule 17a-4 of the Securities Exchange Act of 1934. The record retained must be readily available to the Exchange, upon request.

Rule 351. Reporting Requirements

(a) Each member not associated with a member organization and each member organization shall promptly report to the Exchange whenever such member or member organization, or any member, allied member or registered or non-registered employee associated with such member or member organization:

(1) has violated any provision of any securities law or regulation, or any agreement with or rule or standards of conduct of any governmental agency, self-regulatory organization, or business or professional organization, or engaged in conduct which is inconsistent with just and equitable principles of trade or detrimental to the interests or welfare of the Exchange;

(2) is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery;

(3) is named as a defendant or respondent in any proceeding brought by a regulatory or self-regulatory body alleging the violation of any provision of the Securities Exchange Act of 1934, or of any other Federal or state securities, insurance, or commodities statute, or of any rule or regulation thereunder, or of any agreement with, or of any provision of the constitution, rules or similar governing instruments of, any securities, insurance or commodities regulatory or self-regulatory organization;

(4) is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry regulatory or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member or member organization of any such self-regulatory organization;

(5) is arrested, arraigned, indicted or convicted of, or pleads guilty to, pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in a domestic, military or foreign court;

(6) is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company which was suspended, expelled or had its registration denied or revoked by any agency, jurisdiction or organization or is associated in such a capacity with a bank, trust company or other financial institution which was convicted of, or pleaded no contest to, any felony or misdemeanor;

(7) is a defendant or respondent in any securities or commodities-related civil litigation or arbitration which has been disposed of by judgment, award or settlement for an amount exceeding $15,000. However, when a member organization is the defendant or respondent, then the reporting to the

Exchange shall be required only when such judgment, award or settlement is for an amount exceeding $25,000;

(8) is the subject of any claim for damages by a customer, broker or dealer which is settled for an amount exceeding $15,000. However, when the claim for damages is against a member organization, then the reporting to the Exchange shall be required only when such claim is settled for an amount exceeding $25,000;

(9) is, or learns that he is associated in any business or financial activity with any person who is, subject to a "statutory disqualification" as that term is defined in the Securities Exchange Act of 1934.

(10) is the subject of any disciplinary action taken by the member or member organization against any of its associated persons involving suspension, termination, the withholding of commissions or imposition of fines in excess of $2,500, or any other significant limitation on activities.

(b) Each member associated with a member organization and each allied member or registered or non-registered employee of a member or member organization shall promptly report the existence of any of the conditions set forth in paragraph (a) of this rule to the member or member organization with which such person is associated.

(c) Each approved person shall promptly report to the member organization with which such approved person is associated, whenever such approved person becomes subject to a statutory disqualification as defined in the Securities Exchange Act of 1934; and upon being so notified, or otherwise learning such fact, the member or member organization shall promptly so advise the Exchange in writing, giving the name of the person subject to the statutory disqualification and details concerning the disqualification.

(d) At such intervals and in such detail as the Exchange shall specify, each member not associated with a member organization and each member organization shall report to the Exchange statistical information regarding customer complaints relating to such matters as may be specified by the Exchange. For the purpose of this paragraph (d), "customer" includes any person other than a broker or dealer.

(e) Each member not associated with a member organization and a senior officer or partner of each member organization shall take one or both of the following two actions in relation to the trades that are subject to the review procedures required by Rule 342.21(a):

(i) Sign a written statement in the form specified below and deliver it to the Exchange by the 15th day of the month following the calendar quarter in which the trade occurred, and

(ii) As to any such trade that is the subject of an internal investigation pursuant to Rule 342.21(b), but has not been both resolved and included in the written statement made pursuant to subparagraph (i) above, report in writing to the Exchange:

(A) The commencement of the internal investigation, the identity of the trade and the reason why the trade could not be the subject of a written statement made pursuant to subparagraph (i) above (report by the 15th day of the month, following the calendar quarter in which the trade occurred).

(B) The quarterly progress of each open investigation (report by the 15th day of the month following the quarter).

(C) The completion of the investigation, detailing the methodology and results of the investigation, any internal disciplinary action taken, and any referral of the matter to the Exchange, another self-regulatory organization, the Securities and Exchange Commission or another Federal agency; and including, where no internal disciplinary action has been taken and no such referral has been made, a written statement in relation to the trade in the form specified below (report within one week after completion of the investigation).

The statement that subparagraph (i) requires shall read substantially as follows:

(1) [I/NAME OF MEMBER ORGANIZATION] [have/has] established procedures for reviewing the facts and circumstances surrounding trades in NYSE listed securities and related financial instruments for [my/the] account [of NAME OF MEMBER ORGANIZATION] ("Proprietary Trades") and for the accounts of [my/its] [members, allied members and] employees and their family members, including trades reported by other members or member organizations pursuant to Rule 407, ("Employee Trades"), which procedures [I/NAME OF MEMBER ORGANIZATION] [have/has] determined to be reasonably designed to identify trades that may violate the provisions of the Securities Exchange Act of 1934, the rules under that act or the rules of the Exchange prohibiting insider trading and manipulative and deceptive devices,

(2) I, my designees or the senior supervisors responsible for particular activities have carried out those procedures in relation to Proprietary Trades and Employee Trades effected during the [ORDINAL NUMBER] quarter of [YEAR], and

(3) Based upon my assessment of the adequacy of those procedures and of the diligence of those carrying out those procedures, and except as to those Proprietary Trades and Employee Trades that I have reported to the Exchange pursuant to Rule 351(e)(ii) as the subject of internal investigation, I have no reasonable cause to believe that: (a) any one or more of the Proprietary Trades effected during the period referred to in clause (2) above, or (b) any one or more of the Employee Trades both effected during that period and reviewed under those procedures violated the provisions of the Securities Exchange Act of 1934, the rules under the act or the rules of the Exchange prohibiting insider trading and manipulative and deceptive devices.

When a statement pertains to one or more trades that have been the subject of an internal investigation pursuant to Rule 342.21(b) but as to

which no internal disciplinary action has been taken and no referral of the matter to the Exchange, to another self-regulatory organization or to a Federal agency has been made, the statement that subparagraph (ii) (C) requires shall be as above, except that it shall refer to the particular trade (s) (rather than to the trades of a particular calendar quarter) and shall omit the clause excepting trades reported as the subject of an investigation. For the purpose of this paragraph (e), a "senior officer or partner" means (i) the chief executive officer or managing partner or

(ii) either (A) any other officer or partner who is a member of the member organization's executive or management committee or its equivalent committee or group or (B) if the member organization has no such committee or group, any officer or partner having senior executive or management responsibility who reports directly to the Chief Executive Officer or managing partner. If, in the case of a member organization, its chief executive officer or managing partner does not sign the statement, a copy of the statement shall be provided to the chief executive officer or managing partner.

(f) Each member and member organization that prepares, issues or distributes research reports or whose research analysts make public appearances is required to submit to the member's or member organization's Designated Examining Authority, annually, a letter of attestation signed by a senior officer or partner that the member or member organization has established and implemented procedures reasonably designed to comply with the provisions of Rule 472. The attestation must also specifically certify that each research analyst's compensation was reviewed and approved in accordance with the requirements of Rule 472(h)(2) and that the basis for such approval has been documented.

Amended: March 16, 1972; February 15, 1979; March 26, 1980; May 27, 1988; March 22, 1990; May 3, 2002; July 9, 2002 (2002-09); July 29, 2003 (NYSE-2002-49).

• • • ***Supplementary Material:*** ----------

.10 Any report required pursuant to paragraphs (a), (b) or (d) of this Rule 351 shall be submitted to the Exchange on a form or forms prescribed by the Exchange.

Adopted: February 15, 1979.

Amended: May 27, 1988.

.11 For purposes of Rule 351(f), the attestation must be submitted by April 1 of each year.

Adopted: July 9, 2002 (2002-09).

.12 The term "research report" is defined in Rule 472.10 and the term "public appearance" is defined in Rule 472.50.

Adopted: July 9, 2002 (2002-09).

Amended: July 29, 2003 (NYSE-2002-49).

Rule 344. Research Analysts and Supervisory Analysts

Research analysts and supervisory analysts must be registered with, qualified by, and approved by the Exchange.

Adopted: June 18, 1964.

• • • ***Supplementary Material:*** ----------

.10 For purposes of this Rule, the term "research analyst" includes a member, allied member, associated person or employee who is primarily responsible for the preparation of the substance of a research report and/or whose name appears on such report. Such research analysts must pass a qualification examination acceptable to the Exchange.

.11 For purposes of this Rule, the term "supervisory analyst" includes a member, allied member, or employee who is responsible for preparing or approving research reports under Rule 472(a)(2). In order to show evidence of acceptability to the Exchange as a supervisory analyst, a member, allied member, or employee may do one of the following:

(1) Present evidence of appropriate experience and pass an Exchange Supervisory Analyst Examination (Series 16).

(2) Present evidence of appropriate experience and successful completion of a specified level of the Chartered Financial Analysts Examination prescribed by the Exchange and pass only that portion of the Exchange Supervisory Analyst Examination (Series 16) dealing with Exchange rules on research standards and related matters.

The Exchange publishes a Study Outline for the Research Analyst Examination and the Supervisory Analyst Examination (Series 16).

.12 For purposes of this Rule, the term "associated person" is defined as a natural person engaged in investment banking, or a securities or kindred business, who is directly or indirectly controlling or controlled by a member or member organization, whether or not any such person is registered, applying for registration or exempt from registration with the NYSE.

Amended: October 4, 1973; March 10, 1983; July 29, 2003 (NYSE-2002-49); February 23, 2005 (NYSE-2005-12); April 14, 2005 (NYSE-2005-24).

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/01 Research Analysts

Qualifications

Research Analyst candidates shall qualify by taking the Research Analyst Qualification Examination (Series 86/87). For purposes of this interpretation, the term "research analyst" is defined in Rule 344.10. The Series 86 covers security analysis and valuation of equity securities. The Series 87 covers pertinent rules and regulations of the self-regulatory organizations, and the SEC.

Prerequisite

The General Securities Registered Representative Examination (Series 7) qualification is a prerequisite for any Research Analyst candidate prior to taking either Part I (Series 86) or Part II (Series 87) of the Research Analyst Qualification Examination.

Alternatively, the United Kingdom Limited Registered Representative (Series 17) Examination and the Canadian Limited Registered Representative (Series 37/38) Examination will also serve as prerequisites to taking either Part I or Part II of the Research Analyst Qualification Examination.

In satisfying the Series 7, Series 17 or Series 37/38 examination prerequisite, Research Analyst candidates will not be required to complete the four-month training period required of Registered Representative candidates nor do they have to be approved by the Exchange pursuant to Rule 345.15/02 (see page 3459).

Candidates that have failed either Part I or II of the Research Analyst Qualification Examination must wait 30 days before retaking either part of the examination.

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/01 Qualifications (continued)

Exemptions

Successful completion of Levels I and II of the Charter Financial Analyst ("CFA") Examination administered by the CFA Institute allows a Research Analyst candidate to request an exemption from Part I (Series 86) of the Research Analyst Qualification Examination. If an exemption is granted for Part I (Series 86), a candidate will be qualified as a Research Analyst after passing Part II (Series 87) and the prerequisite examination (i.e., Series 7, 17, or 37/38 examinations).

Successful completion of Levels I and II of the Chartered Market Technician Program ("CMT") administered by the Market Technician Association ("MTA") allows a Research Analyst candidate who prepares only technical research reports to request an exemption from Part I (Series 86) of the Research Analyst Qualification Examination. If an exemption is granted for Part I (Series 86), a candidate will be qualified as a Research Analyst only after passing Part II (Series 87) and the prerequisite examination (i.e., Series 7, 17, or 37/38 examinations).

To qualify for a CFA or CMT exemption a Research Analyst candidate must have: (i) completed the CFA Level II or CMT Level II within two years of application for registration or (ii) functioned as a research analyst continuously since having passed the CFA Level II or CMT Level II. Applicants that have completed the CFA Level II or CMT Level II that do not meet criteria (i) or (ii) may where good cause is shown based upon previous related employment experience make a written request to the Exchange for an exemption.

A technical research report is a research report as defined in Rule 472.10(2) that is based solely on stock price movement and trading volume and not on the subject company's financial information, business prospects, contact with the subject company's management, or the valuation of a subject company's securities.

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/02 Foreign Research Analysts

Exemption

The requirement that a research analyst as defined under NYSE Rule 344.10 must be registered with, qualified by and approved by the Exchange shall not apply where such analyst is an associated person of a member or member organization who is an employee of a non-member foreign affiliate of such member or member organization who contributes to the preparation of the member's or member organizations research reports ("foreign research analyst"), provided the following conditions are satisfied:

- The foreign research analyst resides and is employed in a jurisdiction that the NYSE has determined has registration and qualification requirements or other standards that reflect a recognition of principles that are consonant with NYSE Rule 344 and the research analyst conflicts of interest provisions pursuant to NYSE Rule 472;

- The foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdictions in which the foreign research analyst resides and is employed;

- Members and member organizations have imposed on affiliates that employ foreign research analysts, and the foreign research analysts all research-related standards that the member or member organization imposes on its research reports and research analysts, including the provisions of NYSE Rule 472;

- Members, member organizations and their affiliates that distribute research reports partially or entirely prepared by a foreign research analyst must subject such research reports to pre-use review and approval by a supervisory analyst, as required by NYSE Rule 472;

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/02 Foreign Research Analysts (continued)

- The annual attestation required under NYSE Rule 351(f) must include the global application of NYSE Rule 472 to foreign affiliates that employ foreign research analysts; and

- In addition to the disclosure requirements of NYSE Rule 472, each research report must include a disclosure on the front page stating that:

  "This research report has been prepared in whole or part by foreign research analysts who may be associated persons of the member or member organization. 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."

Disclosure on the front page of each research report must identify:

(1) each affiliate contributing to the research report;
(2) the location of such affiliate; and
(3) the names of the foreign research analysts employed by each contributing affiliate.

The cover page must also contain general disclosure language describing the relationship between the contributing affiliates and the member or member organization.

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/02 Foreign Research Analysts (continued)

The front page of the research report must also refer to a separate "Foreign Affiliate Disclosures" section (similar to the "Required Disclosure" section currently mandated by the NYSE and NASD under Rules 472 and 2711 respectively) located in close proximity to the "Required Disclosure" section.

In this disclosure section, the member or member organization must disclose the following:

(1) information on the nature of the affiliation with the affiliate;
(2) each affiliate's address; and
(3) the primary regulator in the jurisdiction(s) in which each affiliate is located.

Record Keeping

Members and member organization must establish and maintain records that identify those individuals who have availed themselves of this exemption, the basis for such exemption, and evidence of compliance with the conditions of the exemption.

/03 Supervisory Analysts

Qualifications

Supervisory Analyst candidates shall qualify by taking and passing the Supervisory Analyst (Series 16) Examination.

Rule 344 RESEARCH ANALYSTS AND SUPERVISORY ANALYSTS

/03 Supervisory Analysts (continued)

Qualifications (continued)

Experience

Appropriate experience for a candidate for Supervisory Analyst means having at least three years prior experience within the immediately preceding six years involving securities or financial analysis.

Examples of appropriate experience may include the following:

- Equity or Fixed Income Research Analyst;
- Credit Analyst for a securities rating agency;
- Supervising preparation of materials prepared by financial/securities analysts;
- Financial analytical experience gained at banks, insurance companies or other financial institutions;
- Academic experience relating to the financial/securities markets/industry.

Director of Research

A person having the title of "Director of Research" need not be a supervisory analyst as defined by the Rule so long as he/she does not approve research reports. If, however, such a person is in charge of registered representatives, he/she must qualify as a supervisory person under Rule 342.13.

/04 Exemptions

Successful completion of the CFA Level I Examination administered by the CFA Institute (in lieu of completion of Levels, I, II and III for a full CFA designation) will suffice to allow a Supervisory Analyst candidate to qualify by taking Part I of the Series 16 Qualification Examination.

(Next Page No. is 3450)

Rule 345A. Continuing Education For Registered Persons

(a) **Regulatory Element**—No member or member organization shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the continuing education requirements of Section (a) of this Rule.

(1) Each registered person shall complete the Regulatory Element of the continuing education program on the occurrence of their second registration anniversary date and every three years thereafter or as otherwise prescribed by the Exchange. On each occasion, the Regulatory Element must be completed within one hundred twenty days after the person's registration anniversary date. A person's initial registration date, also known as the "base date", shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element of the program shall be determined by the Exchange for each registration category of persons subject to the rule.

(2) **Failure to complete**—Unless otherwise determined by the Exchange, any registered persons who have not completed the Regulatory Element of the program within the prescribed time frames will have their registration deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this Rule shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. The Exchange may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(3) **Disciplinary Actions**—Unless otherwise determined by the Exchange, a registered person will be required to re-take the Regulatory Element of the program and satisfy the program's requirements in their entirety in the event such person:

(i) becomes subject to any statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 (see also Rule 346(f));

(ii) becomes subject to suspension or to the imposition of a fine of $5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(iii) is ordered pursuant to a disciplinary proceeding to re-take the Regulatory Element by any securities governmental agency or securities self-regulatory organization.

A re-taking of the Regulatory Element shall commence with participation within one hundred twenty days of the registered person becoming subject to the statutory disqualification, in the case of (i) above, or the completion of the sanction or the disciplinary action becoming final, in

the case of (ii) and (iii) above. The date that the disciplinary action becomes final will be deemed the person's new base date for purposes of this Rule.

(b) **Firm Element**

(1) **Persons Subject to the Firm Element**—The requirements of Section (b) of this Rule shall apply to any registered person who has direct contact with customers in the conduct of the member's or member organization's securities sales, trading or investment banking activities, and to the immediate supervisors of such persons, and to registered persons who function as supervisory analysts, and research analysts as defined in Rule 344 (collectively, "covered registered persons").

(2) **Standards**

(i) Each member and member organization must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skills and professionalism. At a minimum, each member and member organization shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the member's or member organization's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. If a member's or member organization's analysis determines a need for supervisory training for persons with supervisory responsibilities, such training must be included in the member's or member organizations's training plan.

(ii) **Minimum Standards for Training Programs**—Programs used to implement a member's or member organization's training plan must be appropriate for the business of the member or member organization and, at a minimum, must cover the following matters concerning securities products, services and strategies offered by the member or member organization:

a. General investment features and associated risk factors;

b. Suitability and sales practice considerations; and

c. Applicable regulatory requirements.

(iii) **Administration of Continuing Education Program**—Each member and member organization must administer its continuing education program in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(3) **Participation in the Firm Element**—Covered registered persons included in a member's or member organization's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the member or member organization.

(4) **Specific Training Requirements**—The Exchange may require a member or member organization, either individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the Exchange deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

Amendments. March 3, 1998; July 29, 2003 (NYSE-2002-49); September 16, 2004 (SR-NYSE-2004-33)

• • • ***Supplementary Material:*** ----------

.10 For purposes of this Rule, the term "registered person" means any member, allied member, registered representative, or other person registered or required to be registered under Exchange rules, but does not include any such person whose activities are limited solely to the transaction of business on the Floor with members or registered broker-dealers.

.20 For purposes of this Rule, the term "customer" means any natural person or any organization, other than a registered broker or dealer, executing transactions in securities or other similar instruments with or through, or receiving investment banking services from, a member or member organization.

.30 Any registered person who has terminated association with a registered broker or dealer and who has, within two years of the date of termination, become reassociated in a registered capacity with a registered broker or dealer shall participate in the Regulatory Element of the continuing education program at such intervals that apply (second registration anniversary and every three years thereafter) based on the initial registration anniversary date, rather than based on the date of reassociation in a registered capacity.

Any former registered person who becomes reassociated in a registered capacity with a registered broker or dealer more than two years after termination as such will be required to satisfy the program's requirements in their entirety (second registration anniversary and every three years thereafter), based on the most recent registration date.

Amendment. March 3, 1998.

.40 Any registration that is deemed inactive for a period of two calendar years pursuant to section (a)(2) of this Rule for failure of a registered person to complete the Regulatory Element, shall be terminated. A person whose registration is so terminated may become registered only by reapplying for registration and satisfying applicable registration and qualification requirements of Exchange rules (see Rule 345).

Adopted. January 30, 1995.

.50 Pursuant to Rule 345A(b)(1), all persons registered as research

analysts and supervisory analysts pursuant to Rule 344 must participate in a Firm Element Continuing Education program that includes training in applicable rules and regulations, ethics, and professional responsibility.

Adopted. July 29, 2003 (NYSE-2002-49).

NASD Manual

2711. Research Analysts and Research Reports

***NASD members must implement the provisions of Rule 2711 no later than Tuesday, July 9, 2002, except for those sections which indicate a different implementation date below ***

(a) Definitions

For purposes of this rule, the following terms shall be defined as provided.

(1) "Investment banking department" means any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.

(2) "Investment banking services" include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs or similar investments; or serving as placement agent for the issuer.

(3) "Member of a research analyst's household" means any individual whose principal residence is the same as the research analyst's principal residence.

(4) "Public appearance" means any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity , or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

(5) "Research analyst" means the associated person who is primarily 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."

(6) "Research analyst account" means any account in which a research analyst or member of the research analyst's household has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940.This term 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.

(7) "Research department" means any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a research report on behalf of a member.

(8) "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.

(9) "Subject company" means the company whose equity securities are the subject of a research report or a public appearance.

(b) Restrictions on Relationship with Research Department

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no personnel engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department or any other employee of the member who is not directly responsible for investment research ("non-research personnel"), other than legal or compliance personnel, may review or approve a research report of the member before its publication.

(3) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or identify any potential conflict of interest, provided that:

(A) 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 or in a transmission copied to such personnel; and

(B) 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 intermediary or in a conversation conducted in the presence of such personnel.

(c) Restrictions on Communications with the Subject Company

(1) Except as provided in paragraphs (c)(2) and (c)(3), a member may not submit a research report to the subject company before its publication.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in 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 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 must retain copies of any draft and the final version of such a research report for three years following its publication.

**** NASD members must implement the provisions of Rule 2711(c)(2) no later than Wednesday, September 9, 2002****

(3) The member may notify a subject company that the member intends to change its rating of the subject company's securities, provided that the notification occurs on the business day before the member announces the rating change, after the close of trading in the principal market of the subject company's securities.

(4) No research analyst may participate in efforts to solicit investment banking business. Accordingly, no research analyst may, 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.

(5) 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.

(6) 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

(B) directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction.

(7) 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.

(d) Restrictions on Research Analyst Compensation

(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) 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's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing such a research analyst's compensation, if applicable:

**** NASD members must implement the following provisions of Rule 2711(d)(2) no later than October 27, 2003****

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in reviewing and approving such a research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each such research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each such research analyst's compensation and documented the basis upon which this compensation was established.

(e) Prohibition of Promise of Favorable Research

No member may 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.

(f) Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage

(1) No member may publish or otherwise distribute a research report and no research analyst may make a public appearance regarding a subject company for which the member acted as manager or co-manager of:

(A) an initial public offering, for 40 calendar days following the date of the offering; or

(B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

(i) paragraphs (f)(1)(A) and (f)(1)(B) will not prevent a member from publishing or

otherwise distributing a research report, or prevent a research analyst from making a public appearance, concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that legal or compliance personnel authorize publication of that research report before it is issued or authorize the public appearance before it is made; and

(ii) paragraph (f)(1)(B) will not prevent a member from publishing or otherwise distributing a research report pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), and will not prevent a research analyst from making a public appearance concerning such a company.

(2) No member that 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 may publish or otherwise distribute a research report or make a public appearance regarding that issuer for 25 calendar days after the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term "date of the offering" refers 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.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member has entered into with a 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. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company with "actively traded securities," as defined in Regulation M, 17 CFR 242.101(c)(1), or to a public appearance concerning such a subject company.

(5) If a member intends to terminate its research coverage of a subject company, notice of this termination must be made. The member must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The 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 to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the member or if the member 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's rationale for the decision to terminate coverage.

(g) Restrictions on Personal Trading by Research Analysts

(1) No research analyst account may purchase or receive any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows.

(2) No research analyst account may purchase or sell 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) a member 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;

(B) a member 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, provided that legal or compliance personnel pre-approve the research report and any change in the rating or price target.

(3) No research analyst account may purchase or sell any 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.

(4) Legal or compliance personnel may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) legal or compliance personnel authorize the transaction before it is entered;

(B) each exception is granted in compliance with policies and procedures adopted by the member 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; and

(C) the member maintains written records concerning each transaction and the justification for permitting the transaction for three years following the date on which the transaction is approved.

(5) The prohibitions in paragraphs (g)(1) through (g)(3) do not apply to a purchase or sale of the securities of:

(A) any registered diversified investment company as defined under Section (5)(b)(1) of the Investment Company Act of 1940; 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.

(6) Legal or compliance personnel of the member shall pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee. This pre-approval requirement shall apply to all persons, such as the director of research, supervisory analyst, or member of a committee, 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.

(h) Disclosure Requirements

(1) Ownership and Material Conflicts of Interest

A member must disclose in research reports and a research analyst must disclose in public appearances:

(A) if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial

interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position);

(B) if, as of the end of the month immediately preceding the date of publication of the research report or 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), the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. Computation of beneficial ownership of securities must be based upon the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Securities Exchange Act of 1934;

***NASD members must implement the provisions of Rule 2711(h)(1)(B) no later than Wednesday, November 6, 2002 ***

(C) any other actual, material conflict of interest of the research analyst or member of which the research analyst knows or has reason to know at the time of publication of the research report or at the time of the public appearance.

(2) Receipt of Compensation

***NASD members must implement the new compensation and client disclosure provisions of Rule 2711(h)(2) no sooner than January 26, 2004 ***

(A) A member must disclose in research reports:

(i) if the research analyst received compensation:

a. based upon (among other factors) the member's investment banking revenues; or

b. from the subject company in the past 12 months.

(ii) the member or affiliate:

a. managed or co-managed a public offering of securities for the subject company in the past 12 months;

b. received compensation for investment banking services from the subject company in the past 12 months; or

c. expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(iii) if (1) 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 (2) to the extent the research analyst or an employee of the member with the ability to influence the substance of the research knows:

a. the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months; or

b. 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. In such cases, the member also must disclose the types of services provided to the subject company. For purposes of this Rule 2711(h)(2), the types of services provided to the subject company shall be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(iv) if, to the extent the research analyst or an employee of the member with the ability to influence the substance of the research report knows an affiliate of the

member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

(v) if, to the extent the research analyst or member has reason to know, an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

a. This requirement will be deemed satisfied if such compensation is disclosed in research reports within 30 days after completion of the last calendar quarter, provided that the member has taken steps reasonably designed to identify any such compensation during that calendar quarter. This requirement shall not apply to any subject company as to which the member initiated coverage since the beginning of the current calendar quarter.

b. The research analyst and the member 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 maintains and enforces policies and procedures reasonably designed to prevent the research analysts and employees of the member 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.

(vi) For the purposes of this Rule 2711(h)(2), an employee of the member 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.

(B) A research analyst must disclose in public appearances:

(i) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the past 12 months;

(ii) if the research analyst received any compensation from the subject company in the past 12 months; or

(iii) if, to the extent the research analyst knows or has reason to know, 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. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst.

(C) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(A)(ii)(b) and (c), (h)(2)(A)(iii)(b), or (h)(2)(B)(i) and (iii) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

**** NASD members must implement the provisions of Rule 2711(h)(2)(C) as they apply to disclosures under Rules 2711(h)(2)(A)(ii)(b) and (c) no later than July 29, 2003, and as they apply to disclosures under Rule 2711(h)(2)(A)(iii)(b), (h)(2)(B)(i) and (iii) by Jan. 26, 2004 ****

(3) Position as Officer or Director

A member must disclose in research reports and a research analyst must disclose in public appearances if the research analyst or a member of the research analyst's household serves as an officer, director or advisory board member of the subject company.

(4) Meaning of Ratings

A member must define in its research reports the meaning of each rating used by the member in its rating system. The definition of each rating must be consistent with its plain

meaning.

(5) Distribution of Ratings

(A) Regardless of the rating system that a member employs, a member must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "buy," "hold/neutral," or "sell" rating.

(B) In each research report, the member must disclose the percentage of subject companies within each of these three categories for whom the member has provided investment banking services within the previous twelve months.

(C) The information that is disclosed under paragraphs (h)(5)(A) and (h)(5)(B) must be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

***NASD members must implement the provisions of Rule 2711(h)(5) no later than Wednesday, September 9, 2002 ***

(6) Price Chart

A member must present in any research report concerning an equity security on which the member has assigned any rating for at least one year, a line graph of the security's daily closing prices for the period that the member has assigned any rating or for a three-year period, whichever is shorter. The line graph must:

(A) indicate the dates on which the member assigned or changed each rating or price target;

(B) depict each rating and price target assigned or changed on those dates; and

(C) be current as of the end of the most recent calendar quarter (or the second most recent calendar quarter if the publication date is less than 15 calendar days after the most recent calendar quarter).

***NASD members must implement the provisions of Rule 2711(h)(6) no later than Wednesday, September 9, 2002 ***

(7) Price Targets

A member must disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by a disclosure concerning the risks that may impede achievement of the price target.

(8) Market Making

A member must disclose in research reports if it was making a market in the subject company's securities at the time that the research report was published.

(9) Disclosure Required by Other Provisions

In addition to the disclosure required by this rule, members and research analysts must provide disclosure in research reports and public appearances that is required by applicable law or regulation, including NASD Rule 2210 and the antifraud provisions of the federal securities laws.

(10) Prominence of Disclosure

The disclosures required by this paragraph (h) must be presented on the front page of research reports or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

(11) Disclosures in Research Reports Covering Six or More Companies

When a member distributes a research report covering six or more subject companies, for purposes of the disclosures required in paragraph (h), such research report may direct the reader in a clear manner as to where they may obtain applicable current disclosures in written or electronic format.

(12) Records of Public Appearances

Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (h) of this Rule. Such records must be maintained for three years from the date of the public appearance.

**** NASD members must implement the provisions of Rule 2711(h)(12) no later than Sept. 29, 2003****

(i) Supervisory Procedures

Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule (including the attestation requirements of Rule 2711(d)(2)), and a senior officer of such a member must attest annually to NASD by April 1 of each year that it has adopted and implemented those procedures.

****NASD members must implement the provisions of Rule 2711(i) in accordance with the implementation schedule for Rule 2711 ****

(j) Prohibition of Retaliation Against Research Analysts

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such an unfavorable public appearance.

**** NASD members must implement the provisions of Rule 2711(j) no later than July 29, 2003****

(k) Exceptions for Small Firms

**** NASD members must implement the provisions of Rule 2711(k) no later than July 29, 2003****

The provisions of paragraph (b) shall not apply to members 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. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

Amended by SR-NASD-2004-141 eff. June 6, 2005.
Amended by SR-NASD-2004-003 eff. April 26, 2004.
Amended by SR-NASD-2002-154 eff. July 29, 2003.
Amended by SR-NASD-2002-74 eff. June 4, 2002.
Adopted by SR-NASD-2002-21 eff. April 24, 2002.

Selected Notices to Members: 02-39, 03-44, 05-34.

NASD Manual

1050. Registration of Research Analysts

(a) All persons associated with a member who are to function as research analysts shall be registered with NASD. Before registration as a Research Analyst can become effective, an applicant shall:

(1) be registered pursuant to Rule 1032 as a General Securities Representative; and

(2) pass a Qualification Examination for Research Analysts as specified by the Board of Governors.

(b) For the purposes of this Rule 1050, "research analyst" shall mean an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.

(c) Upon written request pursuant to the Rule 9600 Series, NASD will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has passed:

(1) Levels I and II of the Chartered Financial Analyst ("CFA") Examination; or

(2) if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e), Levels I and II of the Chartered Market Technician ("CMT") Examination; and

(3) 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.

(d) An applicant who has been granted an exemption pursuant to paragraph (c) still must become registered as a General Securities Representative and then complete the regulatory portion of the Research Analyst Qualification Examination (Series 87) before that applicant can be registered as a Research Analyst.

(e) For the purposes of paragraph (c)(2), a "technical research report" shall mean a research report, as that term is defined in Rule 2711(a)(8), that is based solely on stock price movement and trading volume and not on the subject company's financial information, business prospects, contact with subject company's management, or the valuation of a subject company's securities.

(f) The requirements of paragraph (a) shall not apply to an associated person who is an employee of a non-member foreign affiliate who contributes to the preparation of a member's research report ("foreign research analyst"), provided the following conditions are met:

(1) the foreign research analyst resides and is employed in a jurisdiction that NASD has 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 Rule 2711;

(2) the foreign research analyst has satisfied all applicable registration and qualification requirements or other research-related standards in the jurisdiction in which the foreign research analyst resides and is employed;

(3) the NASD member ("U.S. member") 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 Rule 2711 and all other research-related standards the member imposes on its own research reports and research analysts;

(4) the annual compliance attestation submitted by the U.S. member pursuant to Rule 2711(i) must encompass the global application of Rule 2711 to the U.S. member's foreign affiliates that participate in the preparation of the U.S. member's research reports;

(5) all U.S. member 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 Rule 1022; and

(6) in addition to the disclosure requirements of Rule 2711, each U.S. member 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 or member organization. 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.

(7) Members must establish and maintain records that identify those individuals who have availed themselves of the exemption in paragraph (f), specify the basis for such exemption, and evidence compliance with the conditions of paragraph (f).

Amended by SR-NASD-2005-043 eff. April 1, 2005.
Amended by SR-NASD-2005-022 eff. Feb. 4, 2005.
Amended by SR-NASD-2004-020 eff. March 30, 2004.
Amended by SR-NASD-2004-010 eff. Jan. 16, 2004.
Adopted by SR-NASD-2002-154 eff. July 29, 2003.

Selected Notice to Members: 03-44.

NASD Manual

1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with NASD. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(a) Regulatory Element

(1) Requirements

No member shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person unless such person has complied with the requirements of paragraph (a) hereof.

Each registered person shall complete the Regulatory Element on the occurrence of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by NASD. On each occasion, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. A person's initial registration date, also known as the "base date," shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element shall be determined by NASD and shall be appropriate to either the registered representative or principal status of person subject to the Rule.

(2) Failure to Complete

Unless otherwise determined by the Association, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this Rule shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. A registration that is inactive for a period of two years will be administratively terminated. A person whose registration is so terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of the Rule 1020 Series and the Rule 1030 Series. The Association may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(3) Disciplinary Actions

Unless otherwise determined by NASD, a registered person will be required to retake the Regulatory Element and satisfy all of its requirements in the event such person:

(A) is subject to any statutory disqualification as defined in Section 3(a)(39) of the Act;

(B) is subject to suspension or to the imposition of a fine of $5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(C) is ordered as a sanction in a disciplinary action to retake the Regulatory Element by any securities governmental agency or self-regulatory organization.

The retaking of the Regulatory Element shall commence with participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (A) above, or the disciplinary action becoming final, in the case of (B) and (C) above. The date of the

disciplinary action shall be treated as such person's new base date with NASD.

(4) Reassociation in a Registered Capacity

Any registered person who has terminated association with a member and who has, within two years of the date of termination, become reassociated in a registered capacity with a member shall participate in the Regulatory Element at such intervals that may apply (second anniversary and every three years thereafter) based on the initial registration anniversary date rather than based on the date of reassociation in a registered capacity.

(5) Definition of Registered Person

For purposes of this Rule, the term "registered person" means any person registered with NASD as a representative, principal, assistant representative or research analyst pursuant to the Rule 1020, 1030, 1040, 1050 and 1110 Series.

(6) In-Firm Delivery of the Regulatory Element

Members will be permitted to administer the continuing education Regulatory Element program to their registered persons by instituting an in-firm program acceptable to the Association.

The following procedures are required:

(A) Principal/Officer In-Charge. The firm has designated a principal to be responsible for the in-firm delivery of the Regulatory Element.

(B) Site Requirements.

(i) The location of all delivery sites will be under the control of the firm.

(ii) Delivery of Regulatory Element continuing education will take place in an environment conducive to training. (Examples: a training facility, conference room or other area dedicated to this purpose would be appropriate. Inappropriate locations would include a personal office or any location that is not or cannot be secured from traffic and interruptions.)

(iii) Where multiple delivery terminals are placed in a room, adequate separation between terminals will be maintained.

(C) Technology Requirements. The communication links and firm delivery computer hardware must comply with standards defined by the Association or its designated vendor.

(D) Supervision.

(i) The firm's Written Supervisory Procedures must contain the procedures implemented to comply with the requirements of in-firm delivery of the Regulatory Element continuing education.

(ii) The firm's Written Supervisory Procedures must identify the principal designated pursuant to Rule 1120(a)(6)(A) and contain a list of individuals authorized by the firm to serve as proctors.

(iii) Firm locations for delivery of the Regulatory Element continuing education will be specifically listed in the firm's Written Supervisory Procedures.

(E) Proctors.

(i) All sessions will be proctored by an authorized person during the entire Regulatory Element session. Proctors must be present in the session room or must be able to view the person(s) sitting for Regulatory Element continuing education through a window or by video monitor.

(ii) The individual responsible for proctoring at each administration will sign a certification that required procedures have been followed, that no material from

Regulatory Element continuing education has been reproduced, and that no candidate received any assistance to complete the session. Such certification may be part of the sign-in log required under Rule 1120(a)(6)(F).

(iii) Individuals serving as proctors must be persons registered with an SRO and supervised by the designated principal for purposes of in-firm delivery of the Regulatory Element continuing education.

(iv) Proctors will check and verify the identification of all individuals taking Regulatory Element continuing education.

(F) Administration.

(i) All appointments will be scheduled in advance using the procedures and software specified by the Association to communicate with the Association's system and designated vendor.

(ii) The firm/proctor will conduct each session in accordance with the administrative appointment scheduling procedures established by the Association or its designated vendor.

(iii) A sign-in log will be maintained at the delivery facility. Logs will contain the date of each session, the name and social security number of the individual taking the session, that required identification was checked, the sign-in time, the sign-out time, and the name of the individual proctoring the session. Such logs are required to be retained pursuant to SEC Rules 17a-3 and 17a-4.

(iv) No material will be permitted to be utilized for the session nor may any session-related material be removed.

(v) Delivery sites will be made available for inspection by the SROs.

(vi) Before commencing in-firm delivery of the Regulatory Element continuing education, members are required to file with their Designated Examining Authority ("DEA"), a letter of attestation (as specified below) signed by a principal executive officer or executive representative, attesting to the establishment of required procedures addressing principal in-charge, supervision, site, technology, proctors, and administrative requirements. Letters filed with NASD Regulation, Inc. should be sent to Member Regulation, Continuing Education Department, 9509 Key West Avenue, Rockville, MD 20850.

Letter of Attestation for In-Firm Delivery of Regulatory Element Continuing Education

[Name of member] has established procedures for delivering Regulatory Element continuing education on its premises. I have determined that these procedures are reasonably designed to comply with SRO requirements pertaining to in-firm delivery of Regulatory Element continuing education, including that such procedures have been implemented to comply with principal/officer in-charge, supervision, site, technology, proctors, and administrative requirements.

Signature

_____

Printed name

_____

Title [Must be signed by a Principal Executive Officer (or Executive Representative) of the firm]

_____

Date

(7) Regulatory Element Contact Person

Each member shall designate and identify to NASD (by name and e-mail address) an individual or individuals responsible for receiving e-mail notifications provided via the Central Registration Depository regarding when a registered person is approaching the end of his or her Regulatory Element time frame and when a registered person is deemed inactive due to failure to complete the requirements of the Regulatory Element program, and provide prompt notification to NASD regarding any change in such designation(s). Each member must review and, if necessary, update the information regarding its Regulatory Element contact person(s) within 17 business days after the end of each calendar quarter to ensure the information's accuracy.

(b) Firm Element

(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to Rule 1050, and to the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

(2) Standards for the Firm Element

(A) Each member must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each member shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the member's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element. If a member's analysis establishes the need for supervisory training for persons with supervisory responsibilities, such training must be included in the member's training plan.

(B) Minimum Standards for Training Programs — Programs used to implement a member's training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

(i) General investment features and associated risk factors;

(ii) Suitability and sales practice considerations;

(iii) Applicable regulatory requirements; and

(iv) With respect to registered research analysts and their immediate supervisors, training in ethics, professional responsibility and the requirements of Rule 2711.

NASD members must implement the provisions of Rule 1120(b)(2)(B)(iv) on January 26, 2004, or such later date as determined by NASD

(C) Administration of Continuing Education Program — A member must administer its continuing education programs in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(3) Participation in the Firm Element

Covered registered persons included in a member's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the member.

(4) Specific Training Requirements

The Association may require a member, individually or as part of a larger group, to provide specific training to its covered registered persons in such areas as the Association deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

Amended by SR-NASD-2004-098 eff. April 4, 2005.
Amended by SR-NASD-2003-183 eff. April 16, 2004.
Amended by SR-NASD-2002-154 eff. July 29, 2003.
Amended by SR-NASD-2000-64 eff. March 11, 2001.
Amended by SR-NASD-98-03 eff. July 1, 1998.
Amended by SR-NASD-95-22 eff. July 1, 1995.
Adopted by SR-NASD-94-72 eff. July 1, 1995.

Selected Notices to Members: 94-59, 95-13, 95-35, 96-27, 98-23, 01-14, 03-44, 04-22, 05-20.

Notice to Members

JULY 2002

SUGGESTED ROUTING

Executive Representative

Legal & Compliance

Operations

Senior Management

KEY TOPICS

Advertising

Investment Banking

Research Reports

Research Analysts and Research Reports

SEC Approves Rule Governing Research Analysts' Conflicts of Interest

Executive Summary

On May 10, 2002, the SEC approved new NASD Rule 2711, Research Analysts and Research Reports. The rule is intended to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions. The SEC also approved on that day similar proposed amendments to New York Stock Exchange (NYSE) Rule 472. The rules will be implemented in phases during the period from July 9, 2002, to November 6, 2002.

This *Notice* includes as Attachment A the text of the new rule and the implementation schedule of the rule's effective dates. This *Notice* also includes as Attachment B a Joint Memorandum of NASD and the NYSE that provides interpretive guidance for the NASD and NYSE rules governing research reports and analysts.

Research Reports Must Reflect an Analyst's Actual Opinion

Rule 2711 is intended to restore investor confidence in a process that is critical to the equities markets. The rule reflects a self-policing approach consistent with strong self-regulation. Members and research analysts must take all measures that are necessary to ensure that all research reports reflect an analyst's honest views and that any opinion or recommendation is not influenced by conflicts of interest. If a member issues a report or a research analyst renders an opinion that is inconsistent with the analyst's actual views regarding a subject company, NASD considers such action to constitute a fraudulent act and conduct inconsistent with just and equitable principles of trade.

Disclosure Required by NASD Rule 2210

The Joint Memorandum discusses interpretive issues that are common to NASD Rule 2711 and NYSE Rule 472 with regard to research reports and research analysts. Members should refer to the Joint Memorandum for a discussion of most of these interpretive issues.

One issue is unique to NASD members, however, and thus covered in this *Notice*. In addition to the disclosures required by Rule 2711, NASD members and research analysts must provide disclosure in research reports that is required by NASD Rule 2210. In two cases, Rule 2711's disclosure requirements operate differently than those under Rule 2210.

First, Rule 2210(d)(2)(B)(i)(a) requires disclosure if the member *"usually makes a market* in the securities being recommended," while Rule 2711(h)(8) requires disclosure if the member "was making a market in the subject company's securities *at the time that the research report was published."* Second, Rule 2210(d)(2)(B)(i)(c) requires disclosure if the member was manager or co-manager of a public offering of any securities of the recommended issuer within the last three years, while Rule 2711(h)(2)(A)(ii)(a) only requires disclosure of this information for the past *12 months.*

In these two situations, a member's compliance with the requirements of Rule 2711(h) will override the disclosure requirements of Rule 2210(d)(2)(B)(i). Members still must comply with all other disclosure requirements of Rule 2210, such as those regarding buying or selling securities on a principal basis and ownership of options, rights, or warrants. Additionally, member communications other than research reports remain subject to all applicable provisions of Rule 2210, including those regarding recommendations.

Questions/Further Information

Questions or comments concerning NASD Rule 2711 or this *Notice* may be directed to the NASD Corporate Financing Department at (240) 386-4623.

Information Memo

Member Firm Regulation

New York Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

NYSE

Number 02-26
June 26, 2002

ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS, RESEARCH, COMPLIANCE, LEGAL, AND INVESTMENT BANKING DEPARTMENTS

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: DISCLOSURE AND REPORTING REQUIREMENTS

On May 10, 2002, the Securities and Exchange Commission approved amendments to Exchange Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements")[1] (see attached Exhibit B). The SEC also simultaneously approved new NASD Rule 2711 ("Research Analysts and Research Reports").

The amendments place prohibitions and/or restrictions on Investment Banking Department, Research Department and Subject Company relationships and communications and impose new disclosure requirements on members and member organizations and their associated persons. The amendments are intended to increase associated persons' (research analysts) independence from influences within their firms and provide disclosure of conflicts of interests which might potentially bias such associated persons and the research reports they produce.

This Information Memo includes a Joint Memorandum of NYSE and NASD (see attached Exhibit A) that provides interpretive guidance for the new NYSE and NASD Rules as well as the implementation schedule for the Rules (please see NYSE Information Memo No. 02-24, dated May 20, 2002, for additional information).

Questions regarding this Memo may be directed to William Jannace at (212) 656-2744 or Mary Anne Furlong at (212) 656-4823.

Salvatore Pallante
Executive Vice President

Attachments

[1] SR-NYSE-2002-09, Securities Exchange Act Release No. 45908 (May 10, 2000).

NYSE
New York Stock Exchange

NASD

JOINT MEMORANDUM
OF
NASD AND THE NEW YORK STOCK EXCHANGE

Discussion and Interpretation of Rules Governing Research Analysts and Research Reports (NASD Rule 2711 and NYSE Rules 351 and 472)

Background

On May 10, 2002, the Securities and Exchange Commission ("SEC") approved new NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to New York Stock Exchange ("NYSE") Rules 351 ("Reporting Requirements") and 472 ("Communications with the Public") with respect to research analysts and research reports (collectively, NASD Rule 2711 and the amendments to NYSE Rules 351 and 472 are referred to as the "SRO Rules").

The SRO Rules implement reforms designed to increase analyst independence and to provide more extensive disclosure of conflicts of interest in research reports and public appearances. Generally, the SRO Rules restrict the relationship between research and investment banking departments; require disclosure of financial interests in covered companies by the analyst and the firm; require disclosure of existing and potential investment banking relationships with subject companies; impose quiet periods for the issuance of research reports; restrict personal trading by analysts; and require disclosure of information that helps investors track the correlation between an analyst's rating and the stock's price movements.

The SRO Rules are being phased in to give members time to adopt compliant systems and procedures. Most provisions of the Rules will go into effect on July 9, 2002, with the following exceptions. The provisions requiring disclosure of firm ownership of 1% or more of any class of common equity securities of the subject company[1] and related written procedures[2] become effective November 6, 2002. The following rules and their accompanying written procedures become effective on September 9, 2002: the gatekeeper functions;[3] the required disclosure of ratings distribution;[4] and the price charts.[5] The NYSE had previously issued an information

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[1] NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

[2] NASD Rule 2711(i) and NYSE Rule 472(c).

[3] NASD Rule 2711(b)(2) and (3), NASD Rule 2711(c)(1) and (2) and NYSE Rule 472(b)(2) and (3).

[4] NASD Rule 2711(h)(5) and NYSE Rule 472(k)(2)(iv).

[5] NASD Rule 2711(h)(6) and NYSE Rule 472(k)(2)(v).

memo outlining the implementation schedule (see NYSE Information Memo No. 02-24, dated May 20, 2002).

In its approval order, the SEC noted that NASD and the NYSE (collectively, the "SROs") would provide interpretive guidance on certain provisions of the SRO Rules. This Joint Memorandum provides that guidance, and addresses certain other issues that NASD and NYSE members have raised since the SEC approved the SRO Rules. This Joint Memorandum does not attempt to address every possible interpretive question or factual scenario that might arise under the Rules. As with other SRO Rules, the NASD and NYSE staffs will consider additional requests for interpretive guidance on a case-by-case basis.

For purposes of the NYSE Rules, the term "research analyst" as used in the Joint Memorandum refers to any "associated person" as that term is defined in NYSE Rule 472.40. In addition, for purposes of the NYSE Rules, the term "member" refers to both members and member organizations of the NYSE.

Definitions

The SRO Rules include a number of definitions that are important to their application. Certain of these definitions are discussed in more detail below.

Investment Banking Services

The SRO Rules[6] define "investment banking services" to include, without limitation, acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs (private investment, public equity transactions) or similar investments; or serving as placement agent for the issuer. The term also includes acting as a member of a selling group in a securities underwriting.

Household Members

NASD Rule 2711(a)(3) defines the term "member of a research analyst's household," and NYSE Rule 472.40 defines the term "household member," to mean any individual whose principal residence is the same as the research analyst's principal residence. These terms do *not* include, however, a roommate, apartment mate or other *unrelated* person who shares the same residence as a research analyst if that person is not financially dependent on the research analyst, or the research analyst is not financially dependent on that person.

Public Appearance

"Public appearance" is defined in the SRO Rules[7] to mean any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security. This term includes a research analyst's participation in a conference call or web cast that is open to the public in which the analyst makes a recommendation or offers an opinion concerning an equity security.

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[6] NASD Rule 2711(a)(2) and NYSE Rule 472.20

[7] NASD Rule 2711(a)(4) and NYSE Rule 472.50

Research Analyst and Associated Person

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."

These terms do not include every registered person who may express an opinion on an equity security. Thus, for example, the terms exclude registered representatives who recommend securities to their customers, so long as they do not prepare the substance of research reports and do not report to persons who do prepare research reports. The terms also 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.

Research Analyst Account

NASD Rule 2711(a)(6) defines "research analyst account" to mean any account in which a research analyst or member of the research analyst's household has a financial interest or over which the analyst has discretion or control. NYSE Rule 472 does not include a comparably defined term. However, NYSE Rule 472.40 generally applies the rule's personal trading restrictions and disclosure requirements to any account over which an associated person has a financial interest, or over which the associated person exercises discretion or control. Under both NASD Rule 2711(a)(6) and NYSE Rule 472.40, if a research analyst manages the portfolio investments of a registered investment company, the investment company is not a "research analyst account" for purposes of NASD Rule 2711, and is not subject to the personal trading restrictions or disclosure requirements of NYSE Rule 472.

Research Report

Under the SRO Rules,[8] the term "research report" has four components. A "research report" is (1) a written or electronic communication, (2) that includes an analysis of 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. Members should consider each communication in this context in determining whether it is or is not a "research report." The term "research report" includes any public communication of a member that falls within the definition, regardless of the means of distribution or whether the report of the member is distributed within or outside the United States.

Member communications that mention or discuss particular equity securities come in a variety of forms, and it is not possible to provide a complete list of all types of communications that fall or do not fall within this definition. The issue of whether a particular communication constitutes a "research report" for purposes of the SRO Rules will turn on the individual facts and circumstances surrounding that communication. The SROs generally would *not* consider the following communications to be "research reports":

- Reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index, that do not recommend or rate individual securities.

- Reports commenting on economic, political or market conditions that do not recommend or rate individual securities.

- Technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price.

- Statistical summaries of multiple companies' financial data (including listings of current ratings) that do not include any narrative discussion or analysis of individual companies' data.

- Reports that recommend increasing or decreasing holdings in particular industries or sectors but that do not contain recommendations or ratings for individual securities.

- Notices of ratings or price target changes that do not contain any narrative discussion or analysis of the company, provided that the member simultaneously directs the readers of the notice as to where they may obtain the most recent research report on the subject company that includes the disclosures required by the SRO Rules. In no event should such a notice refer to a research report that contains materially misleading disclosure, i.e., where disclosures are no longer applicable or new disclosures would pertain.

- An analysis prepared by a registered representative for a specific customer's account.

- Internal communications that are not given to customers.

For purposes of this definition, the term "equity security" has the same meaning as defined in Section 3(a)(11) of the Securities Exchange Act of 1934 (the "Exchange Act").[9]

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[8] NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).

[9] *See* 15 U.S.C. 78c(a)(11).

Application of the SRO Rules to Third Party Research

The SROs have received a number of questions regarding whether the SRO Rules apply to research distributed by a member that is produced by a third party. In general, the SRO Rules are intended to address conflicts of interest that can arise when a member produces its own research. When a member distributes research produced by an independent third party generated in accordance with a soft-dollar arrangement, the member's disclosure requirements do not apply. If the independent third-party source of the research is also an NASD or NYSE member, the third-party member firm must comply with the applicable SRO Rules' provisions described below.

In some cases, a member may distribute research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party other than through a soft-dollar arrangement. The member must however, accompany this research with the following disclosures, to the extent applicable:

- the member's and its affiliates' ownership of the subject company's securities;[10]
- that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;[11]
- that the member was making a market in the subject company's securities at the time the research report was published;[12] and
- any other actual, material conflict of interest of the member known at the time of distribution of the research report.[13]

Generally, a member will not be considered to have distributed independent third-party research to a customer when the customer independently requests or accesses such research from the member or the member makes such research available to its customers through the member's or a third party's web site and customers select their own research.

Prohibition of Certain Forms of Analyst Compensation

The SRO Rules[14] expressly prohibit the payment of a "bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services

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[10] NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

[11] Rules NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(ii).

[12] NASD Rule 2711(h)(8) and NYSE Rule 472(k)(2)(i).

[13] NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(i)c. as they pertain solely to the member.

[14] NASD Rule 2711(d) and NYSE Rule 472(h).

transaction." The SROs have received questions as to the continuing validity of existing contractual arrangements that contain compensation agreements contrary to these SRO Rule provisions.

The SROs are of the view that as of the effective date for that provision of the SRO Rules (July 9, 2002), any contractual provision that provides for compensation based upon specific banking transactions that have not yet closed is inconsistent with the SRO Rules. A member may not pay compensation based on specific investment banking transactions that may have been entered into before the effective date but that will not close until after the effective date. However, research analysts may be compensated, pursuant to contractual agreements executed prior to July 9, 2002, for any investment banking transactions that have closed before that date.

Prohibition of Promises of Favorable Research

The SRO Rules[15] prohibit members from directly or indirectly offering a company favorable research, a specific rating or a specific price target, or threatening to change research, a rating or price target, as consideration or inducement for the receipt of business or compensation. These provisions extend to the research, ratings and price targets issued by an affiliate, since the rule prohibits indirect as well as direct actions.

Nevertheless, these provisions are not intended to prevent a member's investment banking department from obtaining a research analyst's view of a prospective client before committing to undertake an investment banking transaction. They also do not prevent a member from agreeing to provide research as part of its investment banking agreement with a subject company, so long as there is no promise of *favorable* research.

Quiet Periods

The SRO Rules[16] generally prohibit a member from publishing a research report on a company for which the member has acted as manager or co-manager for 40 calendar days after an initial public offering and 10 calendar days after a secondary offering. The SRO Rules provide an exception for publication of research concerning the effects of significant news or a significant event relating to the subject company during those quiet periods. For purposes of these Rules "significant news or a significant event" refers to any news or event that is expected to have a material impact on, or that is expected to cause a material change to, the subject company's operations, earnings or financial condition. The SRO Rules also exempt research reports issued pursuant to SEC Rule 139 for certain secondary offerings of "actively-traded" securities as defined in Rule 101(c)(1) of Regulation M of the Exchange Act.

The SRO Rules impose the 40-day or 10-day quiet periods, as applicable, following the date of the offering. Members have requested clarification of the definition of date of the offering. For NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) (regarding IPOs), members should use the effective date of the registration statement as the date of the offering. For some secondary offerings, particularly shelf-offerings, the effective date of registration may not be meaningful for the purposes of the Rules. Accordingly, for NASD Rule 2711(f)(2) and NYSE Rule 472(f)(2), the date of offering is the date on which the secondary shares are first offered to the public.

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[15] NASD Rule 2711(e) and NYSE Rule 472(g).

[16] NASD Rule 2711(f) and NYSE Rule 472(f)(1) and (2).

As noted above, the SRO Rules apply only to "equity security" offerings, as that term is defined in Section 3(a)(11) of the Exchange Act. This definition includes convertible debt offerings. The provisions do not apply with respect to straight debt offerings.

The quiet period requirements only apply to IPOs and secondary offerings that occur on or after July 9, 2002. Offerings that occur before July 9, 2002 are not subject to these provisions.

Personal Trading

The SRO Rules[17] impose a number of restrictions on the personal trading of securities in accounts in which a research analyst or a member of his or her household has a financial interest or over which the analyst has discretion or control. For purposes of both SROs' rules, these accounts are referred to herein as "research analyst accounts."

Prohibition of Purchasing or Receiving Pre-IPO Securities

The SRO Rules[18] prohibit a research analyst account from purchasing or receiving any securities before the issuer's initial public offering if the issuer is principally engaged in the same types of business as companies that the research analyst follows. This prohibition applies to shares of any private company that engages in the same types of business that the analyst follows, regardless of whether the company ever goes public.

The SRO Rules do not require a research analyst to divest pre-IPO shares of a company that the research analyst already owned before the SRO Rules' effective date. However, research analysts in these situations may not provide research on the company unless the analyst has divested all pre-IPO shares in the company.

The SROs have received questions on the meaning of the term "same types of business as companies that the research analyst covers." 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.

Blackout Periods

The SRO Rules[19] generally prohibit a research analyst account from purchasing or selling 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 5 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. For purposes of this provision, the publication date of a research report is the date that a member first disseminates the report.

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[17] NASD Rule 2711(g) and NYSE Rule 472(e).

[18] NASD Rule 2711(g)(1) and NYSE Rule 472(e)(1).

[19] NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).

Under the SRO Rules[20], a member may permit a research analyst to issue a research report or change a rating or price target for a subject company fewer than 30 days after a research analyst account has traded the subject company's securities if the report or change is due to significant news or a significant event concerning the subject company. The member's legal or compliance department must pre-approve the research report or any change in the subject company's rating or price target.

Exceptions for Investment Funds

The SRO Rules[21] exclude investments in certain investment funds from the personal trading restrictions in NASD Rule 2711(g)(1) through (g)(3) and NYSE Rule 472(e)(1) through (e)(3). The SRO Rules[22] provide that the personal trading restrictions do not apply to investments in registered diversified investment companies as defined in Section 5(b)(1) of the Investment Company Act of 1940.[23] If a research analyst invests in a registered investment company that is not diversified, the investment company must meet the requirements of NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v) in order to be excluded from the personal trading restrictions.

The SRO Rules[24] also exclude any other investment fund over which neither the research analyst nor household member has any investment discretion or control from the personal trading restrictions, provided that the fund meets three criteria. First, the research analyst account(s) collectively owns interests representing no more than 1% of the assets of the fund. Second, the fund invests no more than 20% of its assets in the same types of business as companies that the research analyst follows.[25] Third, if the investment fund distributes securities in kind to the research analyst or household member before the issuer's IPO, 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.

Members have inquired whether holdings of investment funds that were purchased or received prior to July 9, 2002 are excluded from the trading restrictions in the SRO Rules.[26] In general, the SROs will not apply the trading restrictions to these investments. However, if a research analyst or household member makes or receives additional investments in those funds after July 9, 2002, all fund holdings would be subject to the trading restrictions to the extent those funds do not meet the requirements of the SRO Rules.[27]

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[20] NASD Rule 2711(g)(2)(B) and NYSE Rule 472(e)(4)(ii).

[21] NASD Rule 2711(g)(5) and NYSE Rules 472(e)(4)(v) and (vi).

[22] NASD Rule 2711(g)(5)(A) and NYSE Rule 472(e)(4)(vi).

[23] 15 U.S.C. 80a-5(b)(1).

[24] NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

[25] The phrase "same types of business as companies that the research analyst follows" has the same meaning as under the restrictions on purchasing and receiving pre-IPO securities. *See* discussion of NASD Rule 2711(g)(1) and NYSE Rule 472(e)(1).

[26] NASD Rule 2711(g)(1), (2) and (3) and NYSE Rule 472(e)(1), (2) and (3).

[27] NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

Members also have inquired as to when the 1% and 20% tests must be measured. In order to qualify for the trading exceptions of the SRO Rules[28] an investment fund must meet the 1% and 20% tests each time a research analyst makes or receives additional investments in the fund.

Disclosure Requirements

The SRO Rules impose a number of disclosure requirements on members and research analysts with respect both to research reports and public appearances. Members are reminded that there may be additional disclosures required by SEC Rule 10b-5 or other securities laws and rules. Certain of the SRO Rules' disclosure requirements are discussed below.

Member Ownership of Subject Company Securities

The SRO Rules[29] 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 1% or more of any class of common equity securities of the subject company. Several members have requested guidance as to the scope of "affiliate" ownership in this provision, including whether it encompasses mutual funds managed by an affiliated investment adviser, ownership by member employees, and trust accounts managed by an affiliated bank. Members have further inquired whether they may, or must, aggregate their affiliate positions for the purposes of the disclosure requirement.

The SRO Rules refer to Section 13(d) of the Exchange Act for the standards to determine what constitutes beneficial ownership. Thus, 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. Members should look to the SEC rules promulgated pursuant to Section 13(d) and relevant interpretations by the SEC to determine which affiliate holdings must be included in calculating whether firm ownership meets the 1% disclosure threshold. While firms must aggregate those affiliate positions that fall under the Section 13(d) reporting requirements, firms may additionally show those positions disaggregated from the member's own holdings.

The SRO Rules[30] further require disclosure of "any other actual, material conflict of interest" of which the analyst "knows or has reason to know" at the time of the research report or public appearance. Some members have asked whether this requirement creates a duty of inquiry by the analyst to learn of confidential, non-public information. The "knows or has reason to know" language is intended to require disclosure of those material conflicts of interest of which the analyst has actual knowledge, as well as those conflicts that should be reasonably discovered in the ordinary course of business. The provision does not impose a duty on an analyst to inquire concerning confidential, non-public material information that is properly segregated by a firm's informational barriers.

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[28] NASD Rule 2711(g)(5)(B) and NYSE Rule 472(e)(4)(v).

[29] NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)a.

[30] NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(i)c.

Member Receipt of Compensation from Subject Company

The SRO Rules[31] require a member to disclose in research reports if the member or its affiliates: (a) managed or co-managed a public offering of the subject company's securities in the past 12 months; (b) received compensation for investment banking services from the subject company in the past 12 months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months. The Rules do not define the term "affiliate" for purposes of this provision.

The SROs deem that the term "affiliate" includes any company that controls, is controlled by, or is under common control with, the member. "Affiliate" does not include individuals employed by the member or an affiliate. "Control" means the power to direct, or cause the direction of, the management or policies of a company, whether through ownership of securities, by contract or otherwise.[32]

Meaning of Ratings

The SRO Rules[33] require a member to define in its research reports the meaning of each rating used by the member in its ratings system. For example, a member might disclose that a "strong buy" rating means that the rated security's price is expected to appreciate at least 10% faster than other securities in its sector over the next 12-month period.[34] The definition of each rating must be consistent with its plain meaning. Thus, for example, a "hold" rating should not mean or imply that an investor should sell a security.

In some cases, a member may employ multiple ratings systems based upon the investor's time horizon. For example, the member may present ratings for "long," "intermediate" and "short" term investors. In such cases, the member is required to disclose the meanings of the ratings used in each of the ratings systems.

Distribution of Ratings

The SRO Rules[35] require a member to disclose in each research report the percentage of all securities rated by the member to which the member has assigned a "buy," "hold/neutral" or "sell" rating. For example, a research report might disclose that the member has assigned a "buy" rating to 58% of the securities that it follows, a "hold/neutral" rating to 15%, and a "sell" rating to 27%. The SRO Rules[36] require this information to be current as of the end of the most recent calendar quarter . If the publication date of the research report is fewer than 15 calendar days after the end of the most recent calendar quarter, the information must be current as of the second most recent calendar quarter end. If a firm does not employ a rating system that uses the terms

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[31] NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(ii).

[32] *See also* NASD Rule 2720(b)(1) and NYSE Rule 2.

[33] NASD Rule 2711(h)(4) and NYSE Rule 472(k)(2)(iii).

[34] When a rating is defined in terms of a security's performance relative to the market or sector, there is no requirement also to disclose a member's market or sector forecast.

[35] NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(2)(iv).

[36] NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.

"buy," "hold/neutral" and "sell," a member must determine, based on its own ratings system, into which of the three categories its ratings fall.

When a member employs multiple ratings systems based on the investor's time horizon, the member is required to disclose the distributions of the ratings used in each of the ratings systems. As discussed above, the distribution need only reflect ratings of equity securities as defined by Section 3(a)(11) of the Exchange Act.

The SRO Rules[37] require a member to disclose in each research report the percentage of subject companies within each of the three categories (buy, hold/neutral, sell) for whom the member has provided investment banking services within the last 12 months. For example, if 20 of the 25 companies to which the member has assigned a "buy" rating are investment banking clients of the member, the member would have to disclose that 80% of the companies that received a "buy" rating are its investment banking clients.

Price Chart

The SRO Rules[38] require members to include with any research report in which the member has assigned a rating for at least one year a graph that indicates the correlation between the price movement of the subject security and the ratings and price targets assigned by the member. The line graph must cover the period for which a member has assigned a rating or three years, whichever is shorter. This requirement has raised several questions.

First, members have inquired whether a table may be substituted for the chart when the research report is delivered through a technology that will not allow transmission of graphic illustrations. A member may use a table in such circumstances, provided that the table provides all the required data and is presented in an easily readable format. If a table is used rather than a chart, the table is only required to provide the stock closing prices for the days on which the member assigned or changed a rating or price target. However, members may not opt to use a table format if technology is reasonably available to transmit the information as a chart.

Second, members have asked for guidance to comply with the price chart provision when the member employs multiple ratings systems depending on the investor's time horizon (e.g., short, intermediate and long-term). In such cases, the price chart must show the ratings and price targets assigned to the subject company's stock for each ratings system.

Third, members have asked whether the SRO Rules permit inclusion of a benchmark performance, such as the S&P 500 Index, in the price chart. Members may include such benchmarks at their discretion, so long as the information required by the rule is prominent and clearly depicted on the chart. If a member uses a benchmark in a research report's price chart, the member should use the same benchmark in the price charts for all research reports of subject companies within the same industry or peer group.

Fourth, members have inquired whether they must include information about ratings and price targets assigned before the SRO Rules become effective. Members must include that information on price charts for any security that has been assigned a rating for at least a year before a research report is issued. Members have also asked whether the SROs might exempt firms that do not

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[37] NASD Rule 2711(h)(5)(B) and NYSE Rules 472(k)(2)(iv) and 472.70.

[38] NASD Rule 2711(h)(6) and NYSE Rule 472(k)(2)(v).

have the historical information readily available in electronic databases that go back as many as three years from the effective date. The price chart provision does not take effect until September 9, 2002. This date provides adequate time to compile the necessary information, particularly given the fact that existing NASD Rule 2210(b)(2) and NYSE Rule 472(d) (formerly Rule 472(c)) already require firms to maintain a file of all sales literature, including research reports, for three years.

Fifth, members have sought guidance on their obligations when coverage of a security is transferred from one analyst to another, i.e., whether the chart should reflect only the recommendations and price targets of the analyst to whom the security is currently assigned, or whether it should reflect data from all analysts during the period covered by the chart. The price chart is intended to depict the recommendations of the member, not the individual analyst. Consequently, the price chart must reflect all ratings and price targets during the specified period, irrespective of the analyst. The SROs would not object, however, if members chose to include additional information on the price chart that indicates when coverage shifted to a new analyst.

Sixth, some members have asked how "breaks" in coverage affect the obligation to include historical data for securities that have been assigned a rating for at least one year. Breaks in coverage would not restart the clock to determine the one-year coverage period. Moreover, the SROs expect members to indicate the breaks in coverage on the price charts.

Price Targets

The SRO Rules[39] require a member to disclose in research reports the valuation methods used to determine a price target. Price targets must have a reasonable basis and must be accompanied by disclosure concerning the risks that may impede achievement of a price target. This provision however does not require a member to include a price target in a research report.

Prominence of Disclosure

The disclosures required by the SRO Rules must appear on the front page of the research report or the front page must refer to the page on which disclosures are found. Disclosures and references to disclosures must be clear, comprehensive and prominent.

Electronic research reports may utilize hyperlinks to this disclosure, provided that the first screen that the investor sees clearly and prominently labels the hyperlinks to the required disclosures. When hyperlinks are not possible (such as a report in PDF format), members should follow the requirements for paper reports. Thus, for example, the first printed page of a PDF document must either have the disclosures or refer the reader to the pages where the disclosures appear.

Compendium Reports

If a member distributes a research report covering six or more subject companies, the member is not obligated to include the disclosures required by the SRO Rules, provided that the report directs readers in a clear manner as to where they may obtain applicable current disclosures for all covered companies in written or electronic format. In this regard, a compendium report must provide a toll-free number to call or a postal address to write for the required disclosures. Electronic compendium research reports may instead include a hyperlink to the required

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[39] NASD Rule 2711(h)(7) and NYSE Rule 472(k)(2)(ii).

disclosures. Paper research reports may also include a web address of the member where the disclosures are located.

While members are not obligated to include these disclosures in a compendium report so long as the report directs readers to where they may obtain the applicable current disclosures, members are encouraged to disclose in the compendium report the distribution of the member's ratings as required by NASD Rule 2711(h)(5) and NYSE Rule 472(k)(2)(iv). Because this disclosure is not unique to a particular subject company, this disclosure will be the same regardless of the number of subject companies covered in a compendium report.

Public Appearances

The SRO Rules require an analyst to disclose the following when making a recommendation during a public appearance: any financial interest held by the analyst or his or her household members; whether the firm and its affiliates, as of the end of the preceding month, held at least a 1% ownership interest in any class of common equity shares of the subject company; any other material conflict of interest of the analyst or firm of which the analyst knows or has reason to know; and whether the subject company is a client of the member or its affiliates. The term "public appearance" is defined and discussed above.

The SROs have received a number of questions regarding these provisions. First, some members asked whether the rule applies to analysts who make public appearances outside of the United States. The SRO Rules apply to any public appearance by a person who meets the definition of research analyst. They do not apply to employees of non-members unless they also are employees of the member.

Second, the SRO Rules[40] require a research analyst to disclose in public appearances if the analyst knows or has reason to know that the subject company is an investment banking client of the firm. As used herein, the term "client" is intended to include those clients from whom the member received revenues from investment banking services within the last 12 months, or for whom the member expects to provide investment banking services in the next three months, as disclosed in the most recent research report.

Third, several members have inquired whether the public appearance disclosures must be made during an extemporaneous radio or television interview when the research analyst does not possess the required disclosure information. If an analyst cannot make all of the required disclosures during a public appearance then the analyst must decline to make a recommendation or offer an opinion.

A related question is whether a research analyst has complied with the Rules if he or she makes all of the required disclosures during an interview, but the media outlet edits out the disclosures when all or part of the appearance is broadcast. The SROs cannot control the editorial decisions of the media. An analyst will not violate the Rules if he or she makes all of the mandated disclosures with a good faith belief, based on discussions with the media outlet, that those disclosures will be included whenever the appearance is broadcast or rebroadcast. However,

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[40] *See* NASD Rule 2711(h)(2)(B) (which requires disclosure if the research analyst knows or has reason to know that the subject company is a "client" of the member or its affiliates) and NYSE Rule 472(k)(1)(ii) (which requires disclosure if the associated person knows or has reason to know that the subject company is an "investment banking services client" of the member, member organization or one of its affiliates).

when an analyst or a member is aware that a particular media outlet has previously edited out the required disclosures, the SROs expect that an analyst will decline subsequent appearances, absent assurances that the disclosures will not be edited out.

Fourth, members have asked whether the required disclosures may appear in a graphics box or a "scroll" across the screen in lieu of oral disclosures during a television or other video appearance. Such disclosure would satisfy the Rules, provided the graphic includes all of the required information presented in a prominent and readable format during the time of the appearance.

Finally, members have asked for guidance about the types of records that they should maintain to demonstrate compliance with the public appearance provisions of the Rules. Members must maintain records of appearances on television, radio or the Internet that are sufficient to record the statements made by a research analyst. These records may include a transcript or an audio or video tape of such an appearance.

Notice to Members

MARCH 2004

GUIDANCE

Research Analysts and Research Reports

NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest

SUGGESTED ROUTING

Executive Representative
Investment Banking
Legal & Compliance
Operations
Research
Senior Management

KEY TOPICS

Advertising
Investment Banking
Research Reports

Executive Summary

In July 2002, NASD and the New York Stock Exchange (together, the SROs) issued a joint memorandum (the July 2002 Joint Memo) that provides interpretive guidance on NASD Rule 2711 (Research Analysts and Research Reports) and the research analyst provisions of NYSE Rules 351 and 472.[1] Since that time, the SROs have amended their rules governing research analysts and research reports,[2] and members have raised additional questions regarding these rules.

Accordingly, the SROs are issuing a second joint memorandum that provides further interpretive guidance to the research conflict of interest rules. Attachment A is the new joint memorandum. Attachment B is the current version of Rule 2711 for reference. Unless otherwise noted in the new joint memorandum, the guidance included in the July 2002 Joint Memo continues to apply.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-4623; or Philip Shaikun, Associate General Counsel, RPO, at (202) 728-8451.

Endnotes

1 *See Notice to Members 02-39* (July 2002).

2 *See Notice to Members 03-44* (July 2003).

Information Memo

Member Firm Regulation

New York Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

NYSE

Number 04-10
March 9, 2004

ATTENTION: CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS, RESEARCH, COMPLIANCE, LEGAL, AND INVESTMENT BANKING DEPARTMENTS

TO: ALL MEMBERS AND MEMBER ORGANIZATIONS

SUBJECT: AMENDMENTS TO DISCLOSURE AND REPORTING REQUIREMENTS

On July 29, 2003, the Securities and Exchange Commission ("SEC") approved further amendments to Exchange Rule 472 ("Communications with the Public"), and amendments to Rule 351 ("Reporting Requirements"), Rule 344 ("Supervisory Analysts"), and Rule 345A ("Continuing Education for Registered Persons").[1] The SEC also simultaneously approved comparable amendments to NASD Rule 2711 ("Research Analysts and Research Reports"), Rule 1120 ("Continuing Education Requirements") and new Rule 1050 ("Registration of Research Analysts") (collectively NYSE and NASD Rules are referred to as the "SRO Rules").

NYSE and NASD have prepared a Joint Memorandum (see attached Exhibit A) that provides clarification and interpretive guidance to the SRO Rules (see attached Exhibit B for NYSE Rules).

Questions regarding this Memo may be directed to William Jannace at 212-656-2744 or Donald van Weezel at (212) 656-5058.

Salvatore Pallante
Executive Vice President

Attachments

[1] See Securities Exchange Act Release No. 48252 (July 29, 2003), 68 FR 45875 (August 4, 2003) (SR-NYSE-2002-49).

NYSE
New York Stock Exchange

NASD

JOINT MEMORANDUM
OF
NASD AND THE NEW YORK STOCK EXCHANGE

Discussion and Interpretation of Rules Governing Research Analysts and Research Reports (NASD Rule 2711 and NYSE Rules 351 and 472)

Background

This is a follow up to the joint memorandum issued by NASD and the New York Stock Exchange (the "SROs")[1] in July of 2002 (the "July 2002 Joint Memo") that provided interpretive guidance on NASD Rule 2711 ("Research Analysts and Research Reports") and amendments to NYSE Rule 472 ("Communications with the Public") and Rule 351 ("Reporting Requirements") (collectively, the "SRO Rules").[2]

In July 2003, the Securities and Exchange Commission ("SEC") approved further changes to the SRO Rules that imposed new requirements on members[3] and made other changes necessary to comply with research analyst provisions of the Sarbanes-Oxley Act of 2002 (the "July 2003 Amendments").[4] This joint memorandum serves two purposes. First, the memorandum provides further clarification of previously issued interpretive guidance in light of the July 2003 Amendments. Second, it provides further interpretive guidance on the SRO Rules and responds to common questions that members have asked since the July 2002 Joint Memo was issued.

Continued Applicability of July 2002 Joint Memo

Members have inquired whether the guidance provided in the July 2002 Joint Memo continues to apply given the July 2003 Amendments. Unless otherwise noted below in this memorandum, the guidance in the July 2002 Joint Memo continues to reflect the SROs' interpretations of the SRO Rules. This memorandum is organized by subject matter and any change to the previous guidance in the July 2002 Joint Memo is noted in the applicable section.

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[1] *See* NASD Notice to Members 02-39 (July 2002) and NYSE Information Memo No. 02-26 (June 26, 2002), both of which included a Joint Memorandum.

[2] *See* SEC Release No. 34-45908 (May 10, 2000), 67 Fed. Reg. 34968 (May 16, 2002).

[3] For purposes of the NYSE Rules, the term "member" as used in this Joint Memorandum refers to both members and member organizations of the NYSE.

[4] *See* SEC Release No. 34-48252 (July 29, 2003), 68 Fed. Reg. 45875 (Aug. 4, 2003).

Applicability of Registration and Continuing Education Requirements to Fixed Income Research Analysts

Members have inquired whether the new registration and continuing education requirements for research analysts[5] apply to research analysts that only produce research on fixed income securities. As a general matter, the research analyst registration requirements and continuing education requirements apply only to analysts that are the subject to the SRO Rules. That is, these requirements apply only to associated persons that are primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on such a research report. The requirements do not apply to research analysts that only produce research reports on fixed income securities that are not "equity securities" as defined in Section 3(a)(11) of the Securities Exchange Act of 1934.

Definition of "Research Report"

As of September 29, 2003, the term "research report" is defined as "a written or electronic communication that includes an analysis of equity securities or individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision."[6] Previously, the definition also required that the communication include a recommendation. That requirement was deleted in order to conform the SRO Rules to the definition of "research report" in the Sarbanes-Oxley Act.

While the SRO Rules no longer require that a research report contain a recommendation as a determining criteria, the analysis described in the July 2002 Joint Memo generally still applies. Although the issue of whether a communication is a research report still is determined by the individual facts and circumstances surrounding a particular communication, the list of exceptions in the July 2002 Joint Memo that are not generally "research reports" still applies under the new definition. Members should be aware that a disclaimer inserted into a communication with the public that indicates that the communication does not contain information sufficient upon which to base an investment decision has no relevance as to whether the communication falls within the definition of research report and could be misleading in certain circumstances.

Members have inquired whether a client communication that analyzes or recommends individual stocks would be considered a "research report" if it is written by an employee, such as a registered representative, who does not hold the title of "research analyst" and does not work in the member's research department. To clarify this issue, the SROs are adopting the interpretation issued by the SEC with respect to Regulation AC: a client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to

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[5] NASD Rules 1050 and 1120 and NYSE Rules 344 and 345A

[6] NASD Rule 2711(a)(8) and NYSE Rule 472.10(2).

at least 15 persons. This conclusion applies even if the author of the communication does not hold the title of "research analyst" and does not work in the member's research department.

The SROs also are adopting the SEC interpretation regarding periodic reports and other communications prepared for investment company shareholders or discretionary investment account clients.[7] Communications that discuss individual securities in the context of a fund's or account's past performance or the basis for previously made discretionary investment decisions (such as a manager's discussion of fund performance in a mutual fund shareholder report) are generally excluded from the definition of "research report."

Likewise, an investment company portfolio manager that prepares these types of communications would not be considered a "research analyst" for purposes of the SRO Rules even if he or she were registered with a member. However, if such a portfolio manager prepares communications that meet the definition of "research report" and do not fall within the exception noted above, those communications will be subject to the SRO Rules and the portfolio manager will be regarded as a research analyst.

Quantitative and Technical Research Reports

The SROs have continued to receive inquiries as to whether quantitative or technical research reports fall within the definition of "research report" under the SRO Rules. The July 2002 Joint Memo excluded from the definition of "research report" communications of "technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price." The SROs do not believe it is consistent with the purposes of the SRO Rules to exclude technical analysis of individual securities. Such an interpretation could allow a research analyst to provide coverage of a security of an issuer with which the member has an investment banking relationship or where the analyst may have a personal financial interest without the disclosures that would identify such potential conflicts. These are some of the very conflicts the SRO Rules are intended to address. The SEC similarly excluded from the definition of "research report" in Regulation AC only sector, index and industry technical analysis.

The SROs believe the term "quantitative" as applied to research can be subject to various interpretations. Indeed, many research reports typically labeled "quantitative" by members can and do raise conflicts concerns. In this regard, not all mathematical models are inherently objective. Many such models are based on subjective formulas where a person or persons selects or can change the inputs: for example, particular performance ratios or consensus earnings estimates. The SROs are concerned that such models based on subjective formulas could be manipulated to produce a desired result, depending on the ratios or other criteria selected, the universe of securities, and the formula employed.

Consequently, the SROs do not believe it appropriate to categorically exclude any "quantitative" research from the scope of the SRO Rules. Nonetheless, the SROs do recognize that certain "quantitative models" devised by members may sufficiently guard

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[7] *See* SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

against any potential conflicts of interest to render them outside the definition of a "research report." Thus, reports generated by formulas that are generally free of subjective inputs from an employee of a member may fall outside the definition of research report. However, the SROs believe that such a determination is best considered on a case-by-case basis.

Definition of "Public Appearance"

The SRO Rules define the term "public appearance" as "any participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public speaking activity in which a research analyst makes a recommendation or offers an opinion concerning an equity security."[8] Members have inquired whether password-protected conference calls or web casts in which a research analyst provides his or her opinion on individual companies or securities constitute public appearances for purposes of the SRO Rules.

As discussed above, and consistent with SEC Regulation AC, an analysis of individual securities or companies prepared for a specific person or a limited group of fewer than 15 persons is not considered to be a "research report."[9] The SROs believe that a similar standard is appropriate to apply to public appearances. Thus, an appearance before persons representing 15 or more separate investors will be regarded as a public appearance for purposes of the SRO Rules. However, the SROs would not require an analyst to make the disclosures required for public appearances in a password protected web-cast, conference call or similar event with more than 15 existing customers (e.g. individuals or entities), provided (1) all of the call participants previously received the most current research report or other documentation that included the required disclosures and (2) the research analyst making the public appearance corrects and updates any disclosures in the research report that are inaccurate, misleading or are no longer applicable. If representatives of the media attend the public appearance, the analyst must make the required disclosures. Members also are reminded that such appearances are subject to appropriate record keeping requirements, which in this case must include a record of all attendees at the public appearance.

Application of SRO Rules to Third-Party Research

The July 2002 Joint Memo included guidance on the applicability of the SRO Rules to third-party research distributed by a member. That memo states that if a member distributes research produced by a non-member affiliate, such as a foreign broker/dealer or an investment adviser, or an independent third party (other than through a soft dollar arrangement), it must accompany this research with the following "Third-Party Research Disclosures," if applicable:

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[8] NASD Rule 2711(a)(4) and NYSE Rule 472.50.

[9] *See* SEC Release Nos. 33-8193, 34-47384 (Feb. 20, 2003), 68 Fed. Reg. 9481, 9485 (Feb. 27, 2003).

- the member's and its affiliates' ownership of the subject company's securities;[10]

- that the member or its affiliates managed or co-managed a public offering of the subject company's securities in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;[11]

- that the member was making a market in the subject company's securities at the time the research report was published;[12] and

- any other actual, material conflict of interest of the member known at the time of distribution of the research report.[13]

Absent a soft dollar arrangement, when a member distributes another member's research report, the distributing member must include the Third-Party Research Disclosures, while the member that prepared the report must comply with all of the disclosures required by the SRO Rules.

This memorandum addresses three questions that have arisen with respect to third-party research. (1) Are any of the new disclosures required by the recently amended SRO Rules now included in the required Third-Party Research Disclosures? (2) What factors determine whether a research report is considered to be the product of the member rather than its affiliate or an independent third party? (3) Do different rules apply to the distribution of non-member affiliate research and independent third-party research?

Disclosure of Non-Investment Banking Compensation

The July 2003 Amendments to the SRO Rules require a member to provide additional disclosure in research reports regarding compensation that it or its affiliates receive from the subject company. The SRO Rules now require a member to disclose if it received compensation for products or services other than investment banking. This information must be current as of the end of the month 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). A member also must disclose if the analyst or an employee with ability to influence the substance of the research report has actual knowledge as of the date of publication that the member received such compensation.

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[10] NASD Rule 2711(h)(1)(B) and NYSE Rule 472(k)(1)(i)c.

[11] NASD Rule 2711(h)(2)(A)(ii) and NYSE Rule 472(k)(1)(i)a.

[12] NASD Rule 2711(h)(8) and NYSE Rule 472(k)(1)(i)b.

[13] NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(iii)d.

In addition, the July 2003 Amendments also generally require the disclosure in research reports of receipt of non-investment banking compensation received by a member's *affiliates*. However, a member is not required to disclose the receipt of non-investment banking compensation by its affiliates if the member has implemented procedures prescribed by NASD Rule 2711(h)(2)(v)(b) and NYSE Rule 472(k)(1)(iii)a.2. Under these provisions, a member is not required to disclose an affiliate's non-investment banking compensation from a subject company if the member maintains and enforces policies and procedures to wall off research analysts and employees with ability to influence the substance of research reports from receiving information about such compensation.

Finally, a member must disclose if the subject company is or has been during the preceding 12-month period a client of the member. In such cases, the member also must disclose the types of services provided to the subject company, categorized as either investment banking services, non-investment banking securities-related services, or non-securities services.

The SROs will not require a member that distributes third-party research to separately disclose non-investment banking compensation received by the member or an affiliate, unless receipt of that compensation represents an actual, material conflict of interest of the member known at the time of the distribution of the research report. Similarly, a member need not disclose the existence of a client relationship with the subject company, unless such relationship already falls within the current Third-Party Research Disclosures, such as managing or co-managing a public offering of the subject company within the previous 12 months. In sum, members are required to make the same disclosures under the SRO Rules when distributing third-party research as they were required to make prior to the July 2003 Amendments, recognizing that the receipt of non-investment banking compensation can, under certain circumstances, represent a material conflict of interest.

Member vs. Third-Party Research Report

The determination of whether a research report is considered a product of the member or of a third party depends on: (1) whether the report appears to be the product of a member or (2) whether a "research analyst" (as defined by the SRO Rules) associated with a member is involved in producing the research report. It is irrelevant to the analysis where a report is distributed -- domestically or internationally -- or to whom it is distributed, or on which market the subject company's securities are traded.

The SROs consider research reports that meet either of these above factors to be reports produced by the member that must meet all of the SRO Rules' requirements. Thus, for example, if a member issues a "globally-branded"[14] research report, all of the SRO Rules would apply to that report. Similarly, if a member adapts, alters or distributes a research report produced by an affiliate or an independent third party in such a way that an investor reasonably could believe it to be the product of the member, rather than that of the affiliate or independent third party, then

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[14] A "globally-branded" research report refers to the use of a single marketing identity that encompasses the member and its affiliates.

the report will be considered to be the member's own and subject to all of the SRO Rules. A research report prepared by a "mixed research team" that includes at least one person who meets the definition of "research analyst" and is associated with the member also would be considered a report produced by the member.

Independent and Non-Member Affiliate Research Reports

A research report distributed by a member that is produced either by an independent third party or non-member affiliate must include the Third-Party Research Disclosures. In this regard, the interpretations of the SRO Rules treat independent third-party research and non-member affiliate research the same, with one exception. A member that makes a non-member affiliate's research report available to its customers upon request or through its website or a website maintained by the member must include the Third-Party Research Disclosures. However, these disclosures do not apply to independent third-party research that is similarly made available to customers upon request or through a member-maintained website.

Subject Company Review of Research

The SRO Rules require legal or compliance personnel (the "Gatekeepers") to intermediate certain communications between a member's Research Department and companies that are the subject of a research report. Specifically, the SRO Rules[15] provide:

- That a member **may not submit a research report to the subject company prior to publication**, except for the **review of sections of a draft** of the research report solely to verify facts. Members may not, under any circumstances, provide the subject company sections of research reports that include the research summary, the research rating or the price target.

- Prior to **submitting any sections of the research report to the subject company,** the Research Department must provide a complete draft of the research report to the Legal or Compliance Department.

- If after submission to the subject company, the Research Department intends to change the proposed rating or price target, **the Research Department must provide written justification to, and receive prior written authorization from, the Legal or Compliance Department for any change.** The Legal or Compliance Department must retain copies of any drafts and changes thereto of the research reports provided to the subject company.

The SRO Rules prohibit the submission of a research report, in its entirety, to the subject company prior to its publication, even if the research summary, research rating or price

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[15] NASD Rule 2711(c) and NYSE Rule 472(b)(4).

target has been redacted from the report. Providing a report with such information redacted could still enable a subject company to discern the tenor of the report and possibly the company's rating or even price target. The rules only permit submission of sections of a report to verify facts in that section. Submission of facts interspersed with opinions, estimates, conclusions and other non-factually based information by the research analyst violates the SRO Rules. Members should consider submitting to the subject company a separate document containing a summary of facts for which the member seeks verification.

The SROs also wish to clarify the role of the Gatekeepers for purposes of these Rules. Gatekeepers may not merely rubberstamp changes in research reports after sections of the report have been submitted to the subject company. Gatekeepers must review the report and changes thereto, and document the basis for approval. In instances where a change in a rating or price target is to be made, the Gatekeepers must review the written justification provided by the research department, compare it with any comments received from the subject company regarding sections of the draft that had been submitted for factual verification, and conduct such follow-up inquiry as is necessary to establish a reasonable and causal basis for the change.

Restrictions on Publishing Research

Quiet Periods and Blackout Periods

The SRO Rules impose "quiet periods" during which a member may not publish a research report or make a public appearance regarding a subject company for which the member acted as manager or co-manager of a public offering of securities. The SRO Rules impose on managers and co-managers a 40 calendar-day quiet period following an initial public offering ("IPO"), and a 10 calendar-day quiet period (subject to certain exceptions) following a secondary offering.[16] The SRO Rules also impose a 25 calendar-day quiet period on members that have agreed to participate as an underwriter or dealer (other than as a manager or co-manager) of an issuer's IPO.[17]

The SRO Rules also prohibit a member that has acted as manager or co-manager of a securities offering from publishing a research report or making a public appearance concerning a subject company 15 days prior to or after the expiration, waiver or termination of a "lock-up" or similar agreement that restricts the sale of securities after the completion of a securities offering.[18] Finally, the SRO Rules impose a "blackout period" that prohibits a research analyst from purchasing or selling the securities of a company that the analyst follows for a period beginning 30 days before and ending 5 days after the publication of a research report on the subject company or a change in a rating or price target of the company's securities.[19]

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[16] NASD Rule 2711(f)(1) and NYSE Rule 472(f)(1) and (2).

[17] NASD Rule 2711(f)(2) and NYSE Rule 472(f)(3).

[18] NASD Rule 2711(f)(4) and NYSE Rule 472(f)(4).

[19] NASD Rule 2711(g)(2) and NYSE Rule 472(e)(2).

Exceptions to the Quiet Periods and Blackout Periods

The SRO Rules allow a member to publish a research report or make a public appearance during the restricted periods concerning the effects of significant news or a significant event that occurs during those periods, provided that the member's legal and compliance department authorizes publication of the report before it is issued or the public appearance before it is made.[20] Members have asked for additional guidance regarding this exception.

The significant news or event exception is intended to allow for coverage in research reports and public appearances of news or events that have a material impact on, or cause a material change to, a company's operations, earnings or financial condition, and that generally would trigger the filing requirements of SEC Form 8-K. Examples might include the rejection of a patent or drug application; a labor strike; resignation of a chief executive officer or chief financial officer; or a publicly-announced investigation into company activities by a regulator. Members have asked whether a subject company's announcement that it exceeded, met or fell short of expected earnings would constitute significant news permitting an exception to the quiet and blackout periods. As a general matter, the SROs would not regard an announcement about earnings to fall within the exception because an earnings announcement itself generally is not a causal event or news item that materially affects a company's operations, earnings or financial condition. There may be cases, however, where significant news or a significant event has caused the company to exceed or fall short of expected earnings that may permit an exception and allow a member to issue a research report within the quiet or blackout period to the extent that it discusses the news item that affected earnings.

Additionally, members have inquired whether the SRO Rules are intended to limit the content of a research report that is issued during a quiet or blackout period due to a significant event or news item to the effects of the event or news, or whether such a report may discuss any other issues related to 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.

Members also have inquired whether the private placement of a subject company's equity would be a significant event that would allow an exception from the SRO Rules' quiet period provisions. In general, the SROs would not regard the issuance of such securities as a significant event allowing a member to publish research during a quiet period. The private placement of securities is within the issuer's control, and thus not the sort of unforeseen news or event that the SRO Rules contemplated in allowing an exception to the quiet periods.

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[20] NASD Rules 2711(f)(1)(B)(i), 2711(f)(4) and 2711(g)(2)(B), and NYSE Rules 472(e)(4)(ii) and 472(f)(5).

Application of Quiet Periods to Unregistered Offerings

Members further have asked whether the rules imposing quiet periods following secondary offerings and before and after waivers of lock-up agreements apply to non-registered securities offerings. In general, the quiet period following a secondary offering and before and after the waiver of a lock-up agreement applies only to offerings of securities that must be registered for offer or sale in the United States. Thus, quiet periods would not apply to private placements of Rule 144A securities and Regulation S offerings.

Lock-up Agreements and Waivers

Finally, members have inquired as to what date a lock-up agreement is considered waived for purposes of applying the 15-day quiet period before and after the waiver of a lock-up agreement. The 15-day quiet period is triggered based on the first date a shareholder that is subject to a lock-up agreement may sell his or her shares pursuant to the waiver. It is *not* triggered based on the date when an underwriter or other party notifies shareholders that a waiver has been granted. It is also not triggered based on the date when an underwriter or other party registers a securities offering under the federal securities laws.

Since SRO rules do not require lock-up agreements, and since parties to such agreements often are outside the jurisdiction of the NASD or NYSE, the SROs typically cannot determine whether a specific act or contractual provision in a lock-up agreement constitutes a waiver for the purposes of the SRO quiet periods. However, the SROs remind members that the purpose of the quiet period is to prevent members from publishing favorable research that is intended to drive up the price of an issuer's stock for the benefit of certain shareholders who will no longer be subject to a lock-up agreement. Accordingly, the SROs will closely examine research that is issued or otherwise distributed around the time that an underwriting client of the member sells, or first becomes eligible to sell, a significant volume of the subject company's shares.

Personal Trading Restrictions

Members have raised a number of issues with regard to the application of the personal trading restrictions under the SRO Rules.[21]

Trading Against Recommendations

The SRO Rules generally prohibit a research analyst account[22] from purchasing or selling any security or 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

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[21] NASD Rule 2711(g) and NYSE Rule 472(e).

[22] A "research analyst account" includes any account in which a research analyst or member of the research analyst's household has a financial interest, or over which the analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. NASD Rule 2711(a)(6). *See also* NYSE Rule 472.40.

member.[23] Members have inquired as to whether this restriction applies only to recommendations regarding securities of the subject companies covered by the research analyst making the trade, or whether this restriction applies to the recommendations regarding all subject companies covered by the member. This restriction only applies to trades in securities of subject companies covered by the particular research analyst.

Dividend Reinvestment Programs

Members have inquired whether the SROs regard purchases of securities through a dividend reinvestment plan ("DRIP") to be subject to the "blackout periods" on personal trading. The SRO Rules generally prohibit a research analyst account from purchasing or selling 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 5 calendar days after the publication of a research report concerning the company or a rating or price target of the company's securities.

DRIPs typically are plans that allow a participant to reinvest dividends paid on securities held by the participant in the same class of securities of the issuer. Most DRIPs have two components. First, they automatically reinvest cash dividends in the purchase of additional shares of the same securities held by the participant. Second, they permit periodic discretionary cash investments in the same securities. The SROs would not regard automatic reinvestments of dividends in securities of a subject company as covered by the personal trading restrictions' blackout periods. The SROs would reach the same conclusion with respect to automatic reinvestments of dividends in investment funds that are subject to the personal trading restrictions.[24] However, any discretionary cash investments in a subject company's securities, or securities of an investment fund that is subject to the personal trading restrictions, that are made through a DRIP would be subject to the blackout periods.

Short Sales

Where a research analyst has a "sell" (or similar) rating on a subject company's securities, establishes a short position with regard to the securities and later covers the short position, the SROs would regard the covering of the short position as trading contrary to his or her recommendation, since as part of that transaction the analyst would have to buy the securities. Moreover, an analyst may not establish a short position on a rated security during an applicable blackout period.

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[23] NASD Rule 2711(g)(3) and NYSE Rule 472(e)(3).

[24] The SRO Rules exclude from the personal trading restrictions investments in registered diversified investment companies and other investment funds that meet certain criteria. *See* NASD Rule 2711(g)(5) and NYSE Rule 472(e)(4)(v) and (vi).

Trades During "Neutral" Ratings

Some members have inquired whether a research analyst may buy or sell a subject company's securities if the analyst has assigned a "neutral" or "market perform" (or similar) rating to such securities. The SROs regard these (or similar) ratings as the same as a "hold" rating. Accordingly, a research analyst may neither buy nor sell a subject company's securities to which he or she has assigned a hold (or similar) rating.

Changes in Earnings Estimates

Several members have inquired whether the personal trading blackout period would be triggered if a research analyst changed his or her earnings estimates for a subject company, assuming that the change did not coincide with the issuance of a new research report and did not result in a change in the rating or price target for the subject company's securities. These circumstances would not trigger the personal trading blackout period.

Trading Restrictions on Supervisors of Research Analysts

The SRO Rules now require a member's legal or compliance personnel to pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee.[25] The SRO Rules also have been amended to make clear that the research analyst personal trading restrictions do not apply to "blind trusts" that are controlled by a person other than the research analyst or a member of the analyst's household where neither the analyst nor a household member knows of the account's investments or transactions.[26] Likewise, the requirements for legal or compliance personnel to pre-approve securities transactions of supervisory personnel do not apply to transactions within "blind trusts" of which supervisory personnel are the beneficiaries.

The SROs have been asked how the requirement that legal or compliance personnel pre-approve the trades of supervisory personnel applies to an account that is managed by a third party (either an outside manager or an in-house account). As a general matter, the SROs would consider a member to have met its obligations to pre-approve a supervisor's transactions in a managed account where the supervisor has no discretion or control if the member has policies and procedures to monitor the managed account's trades. If such policies and procedures are in place, the SROs would not require legal or compliance personnel to pre-approve each transaction made within the managed account.

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[25] NASD Rule 2711(g)(6) and NYSE Rule 472(e)(5).

[26] NASD Rule 2711(a)(6) and NYSE Rule 472.40.

Disclosure Issues

In reviewing members' research reports, the SROs have found that some reports fail adequately to make the disclosures required by the SRO Rules.[27] This section of the joint memorandum is intended to highlight some of the more common problems that the SROs have found.

Prominence of Disclosures

The first page of a research report must include the disclosures required under the SRO Rules or must refer the reader to the pages on which such disclosures are found. Disclosures, and references to disclosures, must be clear, comprehensive and prominent.[28]

References on the front page of a research report to where disclosures are located must be separated from the report's body text, and in larger font size than the body text. For example, many firms are enclosing the references to disclosure location in a box on the first page of the report that enhances the prominence of the disclosure reference.

A notation on the first page that refers readers to the "end of the report" rather than the specific page is not sufficient. The SRO Rules require a reference to the specific page number or to the last page of the report or to a specific section of the report, such as the appendix. In addition, members may use hyperlinks to direct the reader to the required disclosures only in electronically transmitted reports and compendium reports[29] or as an additional point of reference in written reports.

Regardless of where the required disclosures are placed, they should be labeled using a heading such as "Important Disclosures" or "Required Disclosures" so as to be clearly identifiable. Similarly, the font size of the type must be large enough so that the disclosures are clearly legible and distinguishable from body text, other disclosures or disclaimers.

The "Important (or Required) Disclosures" section must include all applicable required textual disclosures (e.g., market making, ownership positions, compensation, etc.), the price chart, the ratings description, ratings distribution (by number of investment banking clients), the valuation methodology, price target and related risk factors description, in a clear and logical order. As an example, related disclosures such as ratings systems and ratings distributions should be in close proximity.

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[27] See NASD Rule 2711(h) and NYSE Rule 472(k)(1).

[28] NASD Rule 2711(h)(10) and NYSE Rule 472(k)(1).

[29] A "compendium report" is a research report that covers six or more subject companies. See NASD Rule 2711(h)(11) and NYSE Rule 472(k)(1).

Disclosure of Officer or Director Positions

A member is required to disclose in research reports if the research analyst or member of his or her household is an officer, director, or advisory board member of the recommended issuer.[30] This disclosure, if applicable, must include the position held by the research analyst or household member.

Conditional or Indefinite Language

Members are required to disclose in research reports if they own 1% or more of a subject company's equity securities and if they make a market in a subject company's securities at the time the research report is issued. Members also must disclose if the member or its affiliates: (a) managed or co-managed a public offering of equity securities for the subject company in the past twelve months; (b) received compensation for investment banking services from the subject company in the past twelve months; or (c) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.[31]

Members may not use conditional or indefinite language in required disclosures, such as "may have a position" or "may make a market" in any of the subject company's securities, or that the reader "should assume" that the firm or its affiliates engaged in investment banking business with a subject company. The required disclosures with respect to past receipt and expectation of investment banking services related compensation must be made separately, if applicable. For example, a member may not disclose that it "received compensation for investment banking services in the past twelve months *or* expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months." Such disclosure lacks the specificity required by the SRO Rules.

Use of Disclaimers

Research reports may not include general or specific disclaimers that contradict or are inconsistent with disclosures required by SRO Rules. For example, it is inconsistent for a research report to disclose that the member makes a market in the specific securities that are the subject of the research report and separately to disclose generally that the member may make a market in some or all of the securities mentioned in the report.

The presence of disclosures and disclaimers not required by the SRO Rules in close proximity to the disclosures required by the SRO Rules may cause confusion and detract from their readability. Therefore, any disclosures or disclaimers not required by the SRO Rules must be clearly separated and appropriately labeled. If the required disclosures are placed near non-required disclaimers and disclosures, each set of disclosures and

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[30] NASD Rule 2711(h)(3) and NYSE Rule 472(k)(1)(iii)c.

[31] NASD Rule 2711(h)(1)(B), (h)(2)(A)(ii), and (h)(8); NYSE Rule 472(k)(1)(i)a., b., and c.

disclaimers must be clearly labeled, e.g., "Important (or Required) Disclosures," "Other Disclosures," and "Disclaimers." The disclosures required by the SRO Rules also must be separate from disclosures required by foreign jurisdictions.

Use of Stock Symbols

Members may not use stock symbols in the "Important Disclosures" section of the report unless the reader is specifically directed to where in the report the subject companies represented by the symbols are identified by proper names.

Disclosure of Ratings Distributions and Price Charts

The SRO Rules allow members to use any ratings system they deem appropriate in their research reports, so long as they are accompanied by a clear definition of the meaning of each rating used in the system.[32] The SRO Rules require a member to disclose in each research report the percentages of all securities rated by the member to which the member has assigned a "buy", "hold/neutral" or "sell" rating.[33] The SRO Rules also require each report to disclose the percentage of subject companies within each of these three rating categories for whom the member has provided investment banking services within the previous 12 months.[34]

If a member utilizes a ratings system that employs terms different than "buy," "hold/neutral" and "sell," the member must determine, based on its own ratings system, into which of these three categories its ratings fall. The research report must use the terms "buy," "hold" and "sell" in making these ratings distributions disclosures. However, if a member uses a ratings system that employs terms other than "buy," "hold/neutral" and "sell," the member may combine its own ratings terms with those categories required by the SRO Rules to make the ratings distribution disclosures (*e.g.*, "buy/overweight," "hold/equalweight and "sell/underweight").

The SRO Rules specify that information regarding ratings distributions must be current as of the most recent calendar quarter end (or the second most recent calendar quarter end if the publication date is less than 15 days after the most recent calendar quarter).[35] The SRO Rules do not specify, however, what time period the ratings distribution must cover. Some members have noted that they do not regularly issue ratings and thus were uncertain as to how far back the ratings distribution universe must extend. In general, the ratings distribution should include all current ratings of the member. However, if the member does not issue new ratings on a relatively frequent basis, the SROs will consider a member to

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[32] NASD Rule 2711(h)(4) and NYSE Rule 472(k)(1)(i)f.

[33] NASD Rule 2711(h)(5)(A) and NYSE Rule 472(k)(1)(i)g. and 472.70.

[34] NASD Rule 2711(h)(5)(B) and NYSE Rule 472(k)(1)(i)g. and 472.70.

[35] NASD Rule 2711(h)(5)(C) and NYSE Rule 472.70.

have complied with the ratings distribution disclosure requirements if the distribution includes ratings that the member has issued within the past 12 months.

If a research report does not contain any rating – express or implied – of the subject company's stock, the report is not required to include the ratings distribution information required by the SRO Rules. In addition, if the report does not include either a rating or a price target for the subject company's stock, the report is not required to include a price chart.[36]

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[36] See NASD Rule 2711(h)(6) and NYSE Rule 472(k)(1)(i)h.

Comparison of Global Settlement and SRO Rules

Subject	Global Settlement	SRO Rules
Reporting Lines	**Undertaking I.1**	**NASD Rule 2711(b)(1) and NYSE Rule 472(b)(1)**
	Research may not report directly or indirectly through investment banking. Head of research may report to person to whom investment banking head also reports, provided that such person has no direct responsibility for investment banking activities.	No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no person engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.
Definition of "Research Report"	**Undertaking I.1.e**	**NASD Rule 2711(a)(8) and NYSE Rule 472.10(2)**
	Limited to communications to U.S. investors. Excludes quantitative analysis concerning sectors, industries or indexes. Also excludes analyses for current customers (without limit).	Not limited to communications to U.S. investors. Does not exclude quantitative analyses, although interpretations exclude analyses of sectors, industries or indexes. Current customer analysis exclusion limited to 15 customers.
Legal/Compliance	**Undertaking I.2**	**N/A**
	Research must have its own dedicated legal and compliance staff, who may be part of the firm's overall compliance/legal infrastructure.	No similar requirement.
Budget	**Undertaking I.3**	**NASD Rules 2711(d)(2) and (h)(2)(A)(i)(a) and NYSE Rules 472(h)(2) and (k)(1)(ii)a.2**
	Research budget must be determined by senior management without input from investment banking, and without regard to investment banking revenues. Firm revenues as a whole may be considered. Audit Committee must ensure compliance with this provision annually.	A firm's overall profitability may be considered in determining the compensation component of a firm's research budget, but this component may not be based on profitability of firm's investment banking department or division. In addition, if a research analyst's compensation is based upon the firm's overall profitability which includes investment banking revenues, this fact must be disclosed.
Physical Separation	**Undertaking I.4**	**N/A**
	Research and investment banking must be physically separated.	No similar requirement.

Subject	Global Settlement	SRO Rules
Compensation	**Undertaking I.5**	**NASD Rule 2711(d) and NYSE Rule 472(h)**
	Compensation of research personnel must be determined exclusively by research management and firm's senior management based on following principles: (A) Investment banking will have no input. (B) Compensation may not be based on IB revenues or results (firm results OK). (C) A significant portion of the lead analyst's compensation must be based on the quality and accuracy of the lead analyst's research, analysis, ratings and price targets. (D) Certain other factors may be taken into consideration. (E) Compensation criteria determined by research management and firm's senior management (not including IB) and set forth in writing in advance. (F) Research management must document the basis for such compensation. Compensation committee of firm's parent company will conduct annual compliance review.	Analysts may not receive compensation based on a specific investment banking transaction. Lead analysts' compensation must be reviewed and approved by a compensation committee that does not have any representation from the IB department. The committee must consider the following factors: (A) the analyst's individual performance, including his productivity and the quality of his research; (B) the correlation between the analyst's recommendations and the stock price performance; and (C) the overall ratings received from clients, sales force, and peers independent from the firm's IB department, and other independent ratings services. The analyst's contributions to IB department may not be considered. Documentation and attestation requirements.
Evaluations	**Undertaking I.6**	**NASD Rule 2711(d)(2) and NYSE Rule 472(h)(2)**
	Evaluations of research personnel will not be done by, nor will there by input from, investment banking.	Research analyst compensation review committee may not have representation from investment banking.
Coverage	**Undertaking I.7**	**NASD Rules 2711(b)(1) and (b)(3)(A) and NYSE Rules 472(b)(1) and (b)(3)(i)**
	Investment banking will have no input into company-specific coverage decisions (initiation or termination), and IB revenues will not be taken into account in making company-specific coverage decisions. Provision does not apply to industry sector coverage decisions.	No research analyst may be subject to the supervision or control of any employee of a member's investment banking department. In addition, any discussion regarding research coverage would have to be intermediated by legal and compliance.
Termination of Coverage	**Undertaking I.8**	**NASD Rule 2711(f)(5) and NYSE Rule 472(f)(6)**
	Requires a firm to provide a final research report when it decides to terminate coverage of a particular company. Firm must use the same means of disseminating the final report that it ordinarily uses. No final report is required if the prior coverage was purely quantitative. The report must be comparable to prior reports, unless impracticable. The report must disclose notice of termination and the rational for the decision to terminate coverage.	Requires notice of termination if a member intends to terminate coverage of a subject company. Firm must use the same means of disseminating the final report that it ordinarily uses. The report must be comparable in scope and detail to prior reports and must include a final rating or recommendation unless impracticable. If impracticable to produce a final rating or recommendation, report must disclose the rationale for the decision to terminate coverage.

Subject	Global Settlement	SRO Rules
Prohibition on Soliciting Investment Banking Business	**Undertaking I.9**	**NASD Rule 2711(c)(4) and NYSE Rule 472(b)(5)**
	Research is prohibited from participating in efforts to solicit IB business. Among other things, research may not participate in pitches with prospective IB clients or have other communications with companies for the purpose of soliciting IB business.	Same rule.
Firewalls Between Research and Investment Banking	**Undertaking I.10**	**NASD Rules 2711(b)(2) and (b)(3) and NYSE Rules 472(b)(2) and (b)(3)**
	Sets forth detailed "firewall" restrictions regarding communications between research and investment banking during the period that research is assisting IB in selecting prospective IB clients. Allows research personnel to assist in confirming the adequacy of disclosures in offering documents and pricing of transactions subject to certain conditions. Allows research to attend widely attended conferences and firm meetings at which matters of general firm interest are discussed. Allows IB and research to discuss compliance issues in presence of internal compliance personnel. Allows communications between IB and research personnel not related to IB or research without restriction.	Generally requires written or oral communications between non-research and research personnel regarding the content of a research report to be documented and conducted through or in the presence of legal or compliance personnel. Non-research personnel may only review a research report to verify its factual accuracy or to identify potential conflicts of interest.
Road Shows	**Undertaking I.11**	**NASD Rules 2711(c)(5) and (c)(6) and NYSE Rules 472(b)(6)**
	Prohibits research personnel from participating in company or investment banking-sponsored road shows related to a public offering or other IB transaction. IB is prohibited from directing research personnel to engage in marketing or selling efforts to investors with respect to an IB transaction.	Same rule. Also prohibits research analysts from communicating with customers regarding investment banking transactions in presence of IB personnel or company management. Research analyst communications with customers or internal personnel regarding IB transactions must be fair and balanced.

Subject	Global Settlement	SRO Rules
Oversight	**Undertaking I.12**	**N/A**
	Requires firms to create an oversight committee of research management to review changes in ratings or price targets, review reports to determine whether changes in ratings or price targets should be considered, and to monitor overall research report quality. Exceptions for quantitative analysis.	No similar requirement.
Disclosure	**Undertaking II.1**	**NASD Rule 2711(h) and NYSE Rule 472(k)(1)**
	Requires firms to disclose on first page of a research report, in addition to other disclosures required by rule, that firm does or seeks to do business with companies covered by its reports and that as a result, investors should be aware that conflicts of interest could affect the report's objectivity. Requires disclosure of availability of independent research for listed companies. Must disclose that investors should consider the report only as a single factor in making their investment decision.	The SRO Rules have more specific and comprehensive disclosure requirements than these. For example, the SRO Rules require a firm to disclose if it or an affiliate (a) managed or co-managed a public offering of securities for the subject company in the last 12 months, (b) received investment banking compensation from the subject company in the past 12 months, or (c) expects to receive or intends to seek investment banking compensation from the subject company in the next 3 months.
Transparency of Analysts' Performance	**Undertaking II.2**	**NASD Rules 2711(h)(4), (5) and (6) and NYSE Rules 472(k)(1)(i)(f), (g), and (h)**
	Requires firms to make available on their web sites after the conclusion of each quarter certain information regarding the analyst's research for each subject company, such as the date of the report, rating, price target, period within which price target is to be achieved, EPS forecast, and definitions of ratings.	Research analysts must disclose in research reports the meanings of the ratings used in the firm's ratings system, a percentage distribution of the buy, hold and sell ratings that the firm assigns to subject companies it covers, including the percentage of these companies that are firm IB clients, and a price chart that shows the movement of the subject company's stock price and the dates on which the analyst assigned or changed a rating or price target.
Investor Education	**Undertaking II.3**	**N/A**
	Requires firms to pay fine to pay for investor education pursuant to plan administered by SEC, NASD and NYSE, with remainder going to NASAA for same purpose.	No similar requirement.

Subject	Global Settlement	SRO Rules
Applicability	**Undertaking II.4**	**NASD Rule 2711(a)(8) and NYSE Rule 472.10(2)**
	Applies Undertaking restrictions only to research reports that are prepared by the firm and that related to either a U.S. company or a non-U.S. company for which the U.S. is a principal equity trading market. Applies coverage and disclosure requirements, above, to any report furnished by a firm to U.S. investors.	Definition of "research report" does not contain this limitation; thus, it includes research on non-U.S. companies. The SRO Rules require limited disclosures for reports prepared by foreign affiliates and other third-party research distributed to customers.
Policies and Procedures	**Undertaking II.5**	**NASD Rule 2711(i) and NYSE Rule 472(c)**
	Prohibits a firm from knowingly doing indirectly that which it cannot do directly under the Undertaking. Requires firms to adopt policies and procedures reasonably designed to ensure that a firm's associated persons do not seek to influence the contents of research reports for the purpose of obtaining investment banking business. Policies must instruct firm personnel to report violations of this proscription.	Members must adopt and implement procedures reasonably designed to ensure the member and its employees comply with the SRO Rules. Senior officer must attest that the member has adopted and implemented these procedures.
Independent Monitor	**Undertaking II.7**	**N/A**
	Requires each firm to retain at its own expense an independent monitor to review implementation of the Undertaking. Sets forth detailed rules governing how independent monitor will work.	No similar requirement.
Independent, Third-Party Research	**Undertaking III**	**N/A**
	Sets forth detailed requirements for firms to procure and make available for their clients independent research on listed companies that they cover (other than quantitative research).	No similar requirement.
Restrictions on Communications with the Subject Company	**N/A**	**NASD Rule 2711(c)(1) and (c)(2) and NYSE Rule 472(b)(4)**
	No similar provisions.	Members may not submit research reports to subject companies before their publication except to review the factual accuracy of a report, and subject to conditions.

Subject	Global Settlement	SRO Rules
Prohibitions on Promises of Favorable Research	**N/A**	**NASD Rule 2711(e) and NYSE Rule 472(g)(1)**
	No similar provisions.	Members may not offer favorable research or a specific rating or price target, or threaten to change any research, rating or price target to induce the receipt of business or compensation.
Restrictions on Publishing Research	**N/A**	**NASD Rules 2711(f)(1), (2), (3) and (4) and NYSE Rules 472(f)(1), (2), (3), (4) and (5)**
	No similar provisions.	Members are subject to "quiet periods" during which they may not publish research and analysts may not make public appearances following initial and secondary offerings and around the termination, waiver or expiration of "lock-up" agreements, subject to certain exceptions.
Restrictions on Personal Trading by Analysts	**N/A**	**NASD Rule 2711(g) and NYSE Rule 472(e)**
	No similar provisions.	Research analysts face a number of restrictions on the trading of securities that they cover, such as prohibitions on trading against recommendations and trading blackouts around the time research is issued or ratings are changed.
Disclosure Requirements for Analyst Public Appearances	**N/A**	**NASD Rule 2711(h) and NYSE Rule 472(k)(2)**
	No similar provisions.	Research analysts must make disclosures when discussing stocks in public appearances, such as whether the member has received investment banking compensation from the issuer or the analyst has a financial interest in the issuer.
Other Disclosure Requirements for Research Reports	**N/A**	**NASD Rule 2711(h) and NYSE Rule 472(k)(1)**
	No similar provisions.	Members must disclose in research reports firm and analyst ownership of subject company securities and receipt of non-investment banking compensation from subject company.
Retaliation Against Analysts	**N/A**	**NASD Rule 2711(j) and NYSE Rule 472(g)(2)**
	No similar provisions.	Members are prohibited from retaliating against or threatening analysts as a result of adverse or unfavorable research or public appearance written or made by the analyst.
Registration of Research Analysts	**N/A**	**NASD Rule 1050 and NYSE Rules 344 and 473**

Subject	Global Settlement	SRO Rules
	No similar provisions.	Research analysts must pass qualification exams (Series 86/87) and register with their members' SRO. Certain exceptions for foreign and technical analysts.
Analyst Continuing Education Requirements	**N/A**	**NASD Rule 1120 and NYSE Rule 345A**
	No similar provisions.	Research analysts and their supervisors must satisfy certain continuing education requirements.