

Regulatory Notice

08-55

Research Analysts and Research Reports

FINRA Requests Comment on Proposed Research Registration and Conflict of Interest Rules

Comment Period Expires: November 14, 2008

Executive Summary

As part of the process of developing a new, consolidated rulebook (the Consolidated FINRA Rulebook),¹ FINRA is requesting comment on proposed research analyst conflict of interest rules.

The text of proposed FINRA Rules 1223 and 2240 is set forth in Attachment A.

Questions regarding this *Notice* should be directed to Philip Shaikun, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8451.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by November 14, 2008.

Member firms and other interested parties can submit their comments using the following methods:

- Emailing comments to pubcom@finra.org; or
- Mailing comments in hard copy to:

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

October 2008

Notice Type

- Request for Comment
- Consolidated FINRA Rulebook

Suggested Routing

- Compliance
- Legal
- Registration
- Research
- Senior Management

Key Topic(s)

- Registration
- Research Analysts
- Research Reports
- Supervision

Referenced Rules & Notices

- NASD Rule 1050
- NASD Rule 2210
- NASD Rule 2711
- NYSE Rule 344
- NYSE Rule 342
- NYSE Rule 472

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this Notice will be made available to the public on the FINRA Web site. Generally, FINRA will post comments on its site one week after the end of the comment period.²

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.³

Background

NASD Rule 2711 (Research Analysts and Research Reports) and Incorporated NYSE Rule 472 (Communications with the Public) (the Rules) set forth requirements to foster 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 became apparent during the market boom of the late 1990s.

The current NASD and Incorporated NYSE Rules have no significant differences. Generally, the 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 – when the conflicts are considered too pronounced to be cured by disclosure. Several of the Rules' provisions implement the mandates of the Sarbanes-Oxley Act of 2002 (SOx), which proscribes certain conduct and requires some specific disclosures in research reports and public appearances.

NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) require any person associated with a member firm and who functions as a research analyst to be registered as such and pass the Series 86 and 87 exams, unless an exemption applies. A research analyst is defined for the purposes of those rules as “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.”

In December 2005, in response to a Securities and Exchange Commission (SEC or Commission) Order, FINRA and the NYSE submitted to the SEC a joint report on the operation and effectiveness of the research analyst conflict of interest rules. The report concluded that the 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 suggested that investors are benefiting from more balanced and accurate research to aid their investment decisions. The report also recommended certain changes to the Rules to strike 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 member firms on the other. Many of those recommendations are the subject of a FINRA rule filing pending before the SEC (Joint Report Filing) that would be superseded by the proposal in this *Notice*.

Proposal

FINRA proposes replacing the existing Rules with a single rule in the Consolidated FINRA Rulebook and rewriting the research rules in a more streamlined and flexible fashion within the confines set forth in SOx. Within this structure, the new rule would broaden the obligations on member firms to identify and manage research conflicts. It also would incorporate several aspects of the Joint Report Filing and resolve the few differences between that filing and a substantially similar one filed with the SEC by NYSE to amend its Rule 472. Among other things, the proposal additionally codifies an existing interpretation regarding selective dissemination of research and provides further guidance on the subject. The proposal also extends the exemption for firms with limited investment banking activity to include certain aspects related to research analyst compensation determination.

The most significant proposed changes are described generally below. However, FINRA urges member firms to carefully review the entire attached proposed rule text to understand the full extent of the proposed changes. FINRA notes that the proposal renumbers the new rules as FINRA Rules 1223 and 2240. It also reorganizes new Rule 2240 and includes a “Supplementary Material” section that contains some existing rule language and guidance.

Definitions

FINRA proposes to maintain the definitions in the existing Rules, with a few modifications. The proposal:

- ▶ makes minor changes to the definition of “investment banking services” to clarify that such services include all acts in furtherance of a public or private offering on behalf of an issuer.
- ▶ incorporates a proposed change from the Joint Report Filing to the definition of “research analyst account” to clarify that the definition does not apply to a registered investment company over which a research analyst has discretion or control, provided that the research analyst or a member of that research analyst’s household has no financial interest in the investment company, other than a performance or management fee.
- ▶ incorporates the Joint Report Filing proposed change to the definition of “research report” to exclude sales material regarding open-end registered investment companies that are not listed or traded on an exchange and public direct participation programs.
- ▶ moves into this section the definitions of “third-party research report” and “independent third-party research report” that are now in a separate provision of the Rules.

Identifying and Managing Conflicts of Interest

The proposal creates a new section entitled “Identifying and Managing Conflicts of Interest.” The section includes an overarching provision that requires member firms to establish, maintain and enforce policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts. A second provision sets forth more specifically what those policies and procedures must address. They must promote objective and reliable research that reflects the truly held opinions of research analysts and prevent the use of research or research analysts to manipulate or condition the market or favor the interests of the member firm or certain current or prospective clients.

SOx requires rules to prohibit or restrict certain conduct related to the preparation, approval and distribution of research reports and the determination of research analysts’ compensation. The proposal therefore requires at a minimum that the above-referenced policies and procedures be reasonably designed to achieve compliance with the SOx conduct and structural mandates. However, in contrast to the more prescriptive manner in which the current Rules implement the SOx requirements, the proposal provides firms with more flexibility to adopt policies and procedures to effectuate those mandates in a manner consistent with the member firm’s size and organizational structure.

Thus, the proposal requires firms to establish, maintain and enforce policies and procedures that at a minimum:

- prohibit prepublication review, clearance and approval of research reports by persons engaged in investment banking activities and prohibit or restrict such review, clearance and approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel;
- limit the supervision and compensatory evaluation of research analysts to persons who are not engaged in investment banking services transactions;
- establish information barriers and other safeguards to insulate research analysts from pressure by investment banking personnel and other persons who might be biased in their judgment or supervision;
- prevent direct or indirect retaliation against research analysts as a result of content of a research report that may adversely affect a current or prospective client relationship; and
- define quiet periods of at least 10 days after an initial public offering (IPO) during which a member firm must not publish or otherwise distribute research reports, and research analysts must not make public appearances relating to the issuer if the firm has participated as an underwriter or dealer in the offering.⁴

The proposal retains the current requirement that a committee that reports to the member firm's board of directors – or if none exists, a senior executive officer – review and approve the compensation of any research analyst who is primarily responsible for preparation of the substance of a research report. This committee may not have representation from a member firm's investment banking department and may not consider contributions to a member firm's investment banking business in assessing a research analyst's compensation. The committee must consider, among other things, the productivity of the research analyst and the quality and accuracy of his or her research and must document the basis for each research analyst's compensation.

With respect to the quiet-period provision, FINRA notes that the proposal differs from the Joint Report Filing, which proposed a 25-day IPO quiet period for all underwriters and dealers. However, like the Joint Report Filing, the proposal eliminates the 10-day quiet period after secondary offerings. The proposal also eliminates the current quiet periods 15 days before and after the expiration, waiver or termination of a lock-up agreement. FINRA believes that research issued during such periods potentially offers valuable market information, and the other provisions of the research rules and SEC Regulation AC provide sufficient protection that such research will honestly reflect the analyst's beliefs and be free from other conflicts that would undermine the value or integrity of research issued during these periods.⁵

Additionally, the proposal requires firms to adopt policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting participation in the solicitation of investment banking business, road shows and other marketing on behalf of an issuer. This standard largely maintains the existing proscriptions regarding research analyst conduct. The proposal also maintains the current prohibition against promises of particular research or a recommendation or rating as inducement for receipt of business or compensation and prohibits prepublication review by a subject company for purposes other than verification of facts.

Personal Trading Restrictions

The proposal creates a more flexible supervisory approach with respect to research analyst account trading in securities of companies a research analyst covers. The current Rules prohibit ownership of pre-IPO shares in a research analyst's coverage area; impose specific blackout periods during which a research analyst account may not trade covered securities; prohibit trading against recommendation; and require pre-approval by legal and compliance of transactions in covered securities by persons who oversee research analysts. The current Rules carve out specific investments from the trading restrictions and also set forth particular exceptions to the provisions with approval of legal and compliance.

The proposal instead requires firms to establish policies and procedures that restrict or limit research analyst account trading in securities a research analyst covers, any derivatives of such securities and funds whose performance is materially dependent upon the performance of such securities. Such policies and procedures must ensure that research analysts and others with the ability to influence the content of research reports don't benefit in their trading from the knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report. Firms further are required to define financial hardship circumstances, if any, in which a firm would permit a research analyst to trade against his or her recommendation.

Content and Disclosure in Research Reports

With a couple of modifications and exceptions, the proposal mostly maintains the content and disclosure requirements of the current Rules. This is due in large part to SOx, which mandates disclosure in research reports and public appearances of a research analyst's financial interest in a subject company; whether the research analyst or the member firm or its affiliates has received any compensation from the subject company; whether the issuer has been a client of the member firm within a year of the date of publication of the research report or public appearance and the types of services provided to the issuer; whether the research analyst received compensation with respect to a research report based upon the investment banking revenues of the firm; and other material conflicts.

Certain provisions – the distribution of ratings and price chart requirements, for example – have been maintained because FINRA believes they provide valuable information to investors to assess the objectivity of a research report and the accuracy of a research analyst's past recommendations, ratings or price targets.

The proposal requires a member firm to ensure that purported facts in its research reports are based on reliable information. Otherwise, the proposal adopts, with some language modifications, the existing content requirements:

- Any recommendation, rating or price target must have a reasonable basis in fact and be accompanied by a clear explanation of the valuation method utilized and a fair presentation of risks that may impede its achievement.
- Ratings must be clearly defined in each research report and include any time horizon or benchmark on which the rating is based.
- Irrespective of the rating system employed, a member firm must include in each research report that includes a recommendation or rating the percentage of all securities rated by the member firm to which the member firm assigns a “buy”, “hold” or “sell” rating.
- A member firm must disclose in each research report the percentage of subject companies within each of the “buy,” “hold” and “sell” categories for which the firm provided investment banking services within the previous twelve months.
- If a research report contains a rating or price target, the member firm must include a price chart that shows the stock price movement of the subject company's security in relation to the dates on which the firm assigned or changed a rating or price target.

With respect to disclosure of potential conflicts, the proposal requires a member firm to disclose in any research report all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member firm or research analyst on the date of distribution. The proposal includes among such conflicts most of those that must be disclosed under the current Rules, including those related to receipt of investment banking and non-investment banking compensation and market making.

The proposal modifies the requirement to disclose when a member firm or its affiliates owns securities of the subject company. The proposal requires disclosure if a member firm or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member firm or its affiliates beneficially own 1 percent or more of any class of common equity securities of the subject company. The determination of beneficial ownership continues to be based upon the standards used to compute ownership for the purposes of the reporting requirements under Section 13(d) of the Exchange Act.

The proposal retains the general exception to the disclosure requirements in circumstances where disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company. The proposal also continues to permit a member firm that distributes a research report covering six or more companies (compendium report) to direct the reader in a clear manner as to where the applicable disclosures can be found. While an electronic compendium research report may hyperlink to the disclosures – as is the case for any electronic research report – a paper-based compendium report must include a toll-free number or a postal address where the reader may obtain the disclosures. Paper research reports may additionally include a Web address where the disclosures can be found.

FINRA notes that except for electronic research reports, the proposal does not permit Web-based disclosure. The Joint Report Filing proposed such disclosure, but the SEC staff informed FINRA that it interprets SOx to require disclosures in the research report itself, except as noted above. The SEC staff further indicated that it did not intend to use its exemptive authority under the Exchange Act to allow such Web-based disclosure. FINRA continues to advocate Web-based disclosure as more efficient and effective and will consider amending the proposal should the SEC staff change its position.

Public Appearances

The proposal groups in a separate provision the disclosures required when a research analyst makes a public appearance. The required disclosures effectively remain the same as under the current Rules, with one exception: consistent with the above-referenced provision with respect to disclosure in research reports, a research analyst would be required to disclose if a member firm or its affiliates maintain a “significant financial interest in the debt or equity of the subject company,” including, at a minimum, if the member firm or its affiliates beneficially own 1 percent or more of any class of common equity securities of the subject company, as computed in accordance with Section 13(d) of the Exchange Act. The proposal also adopts the requirement under NASD Rule 2711 to maintain records of public appearances sufficient to demonstrate compliance by research analysts with the applicable disclosure requirements. The more prescriptive recordkeeping requirements of Incorporated NYSE Rule 472 would be deleted under the proposal.

Disclosure Required by Other Provisions

With respect to both research reports and public appearances, member firms and research analysts would continue to be required to comply with applicable disclosure provisions of NASD Rule 2210, Incorporated NYSE Rule 472 and the federal securities laws.

Termination of Coverage

The proposal retains in its entirety the provision in the current Rules that requires a member firm to promptly notify its customers if it intends to terminate coverage of a subject company. Such notification must be made using the means of dissemination equivalent to those a member firm ordinarily uses to distribute research reports to its various customers. If practicable, the notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a firm must disclose to its customers the reason for terminating coverage.

Distribution of Member Firms' Research Reports

The proposal codifies an existing interpretation of NASD Rule 2110 and provides additional guidance regarding selective – or tiered – dissemination of a firm's research reports. In that regard, the proposal requires firms to establish policies and procedures to ensure that a research report is not distributed to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the research report. The proposal includes further guidance to explain that firms may provide different research products and services to certain classes of customers, provided the firm discloses its research dissemination practices to all customers. A member firm may, by way of example, differentiate its research product offerings based on the recommendations provided to its trading versus its investing clients, the depth of research content (but not the ultimate recommendation) provided to certain classes of customer as determined by the member or whether such different classes of customers will receive certain research services at all. A firm may not, however, differentiate the timing of the availability of research to any customer within the class of customers eligible to receive a particular research report or product. FINRA understands, however, that customers may actually receive at different times research reports originally made available at the same time because of the mode of delivery elected by the customer eligible to receive such research services (e.g. in paper form versus electronic). However, member firms may not "game" the mode of delivery in order to preference certain customers over others in the timing of receipt of reports.

Distribution of Third-Party Research Reports

The proposal incorporates in their entirety the current provisions regarding distribution and supervision of third-party research. A detailed discussion of those provisions can be found in *Regulatory Notice 08-16*.

Exemption for Firms with Limited Investment Banking Activity

The proposal extends the exemption for firms with limited investment banking activity to include the provision that prohibits investment banking personnel involvement in determining a research analyst's compensation and the requirement that a committee review and approve such compensation.

The current rule exempts such firms – those that over the previous three years, on average per year, have managed or co-managed 10 or fewer investment banking transactions and generated \$5 million or less in gross revenues from those transactions – from the provisions that prohibit a research analyst from being subject to the supervision or control of an investment banking department employee because the potential conflicts with investment banking are minimal. FINRA believes it follows logically to allow those who supervise research analysts under such circumstances also to be involved in the determination of those analysts' compensation. The proposal still prohibits these firms from compensating a research analyst based upon specific investment banking services transactions or contributions to a member firm's investment banking services activities.

Exemption from Registration Requirements for Certain "Research Analysts"

As in the Joint Report Filing, the proposal exempts from the registration and qualification requirements personnel who produce "research reports" but whose primary job is something other than a research analyst (*e.g.* a registered representative or trader). The existing research rules, in accordance with the SOx mandates, 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. FINRA believes that the registration and qualification requirements were intended for those individuals whose principal job function is to produce research, while the balance of the research rules are intended to foster objective analysis, transparency of certain conflicts and to provide beneficial information to investors. As such, the proposed exemption extends only to the registration requirements.

Attestation Requirement

The proposal deletes the requirement to attest annually that the firm has in place supervisory policies and procedures reasonably designed to achieve compliance with the applicable provisions of the rules, including the compensation committee review provision. FINRA notes that firms would remain obligated pursuant to have a supervisory system reasonably designed to achieve compliance with all applicable securities laws and regulations.

Endnotes

- 1 The current FINRA rulebook includes (1) NASD Rules and (2) rules incorporated from NYSE (Incorporated NYSE Rules) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the Transitional Rulebook). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (Dual Members). For more information about the rulebook consolidation process, see *Information Notice 03/12/08 (Rulebook Consolidation Process)*.
- 2 FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See *NASD Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
- 3 Section 19 of the Securities Exchange Act of 1934 (SEA or Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 4 Firms still would be required to comply with any additional quiet periods that the federal securities laws impose.
- 5 The proposal does not incorporate an element of the Joint Report Filing that would have required an additional attestation that a member has a bona fide reason for issuing research during those 15-day periods before and after the expiration, waiver or termination of a lock-up agreement.

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Attachment A

Below is the text of Proposed FINRA Rules 1223 and 2240. With respect to Proposed FINRA Rule 1223, new language is underlined; proposed deletions are in brackets.

* * * * *

[1050.] FINRA Rule 1223. Registration of Research Analysts¹

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

(1) be registered pursuant to NASD 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 1223[1050], “research analyst” shall mean an associated person whose primary job function is to provide investment research and 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]FINRA will grant a waiver from the analytical portion of the Research Analyst Qualification Examination (Series 86) upon verification that the applicant has [passed]:

(1) passed 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),] passed Levels I and II of the Chartered Market Technician (“CMT”) Examination, if the applicant functions as a research analyst who prepares only technical research reports as defined in paragraph (e); 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.

1 The draft text is marked to show changes between NASD Rule 1050 and proposed FINRA Rule 1223. The proposal would delete the corresponding provisions in Incorporated NYSE Rule 344 and Rule Interpretation 344.

(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]2240(a)([8]10), that is based solely on stock price movement and trading volume and not on [the]a subject company’s financial information, business prospects, contact with a 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:

(1) is an employee of a non-member foreign affiliate of a member (“foreign research analyst”),

(2) resides outside the United States, and

(3) contributes, partially or entirely, to the preparation of globally[-] branded or foreign affiliate research reports but does not contribute to the preparation of a member’s research, including a mixed-team report, that is not globally[-]branded.

Provided that the following conditions are satisfied:

(A) A member that publishes or otherwise distributes globally[-] branded research reports partially or entirely prepared by a foreign research analyst must subject such research to pre-use review and approval by a registered principal in accordance with NASD Rule 1022(a)(5) or a supervisory analyst pursuant to NYSE Rule 344.11. In addition, the member must ensure that such research reports comply with [NASD]Rule [2711]2240, as applicable.

(B) In publishing or otherwise distributing globally[-]branded research reports partially or entirely prepared by a foreign research analyst, a member must prominently disclose:

(i) each affiliate contributing to the research report;

(ii) the names of the foreign research analysts employed by each contributing affiliate;

(iii) that such research analysts are not registered/qualified as research analysts with FINRA[with the NYSE and/or NASD]; and

(iv) that such research analysts may not be associated persons of the member and therefore may not be subject to Rule [2711]2240 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(C) The disclosures required by paragraph (f)(3)(B) of this Rule must be presented on the front page of the research report or the front page must refer to the page on which the disclosures can be found. In electronic research reports, a member may hyperlink to the disclosures. References and disclosures must be clear, comprehensive and prominent.

(D) Members 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. Failure to establish and maintain such records shall create an inference of a violation of Rule 1223[1050]. Members must also establish and maintain records that evidence compliance with the applicable content, disclosure and supervision provisions of Rule 2240[2711]. Members must maintain these records in accordance with the supervisory requirements of Rule 3010, and in addition to such requirement, the failure to establish and maintain such records shall create an inference of a violation of the applicable content, disclosure and supervision provisions of Rule 2240[2711].

(E) Nothing in paragraph (f) of this Rule shall affect the obligation of any person or broker-dealer, including a foreign broker-dealer, to comply with the applicable provisions of the federal securities laws, rules and regulations and any self-regulatory organization rules.

(F) The fact that a foreign research analyst avails himself of the exemption in paragraph (f) shall not be probative of whether that individual is an associated person of the member for other purposes, including whether the foreign research analyst is subject to the Rule 2240[2711] restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

(G) A member that distributes non-member foreign affiliate research reports that are clearly and prominently labeled as such must comply with the third-party research report requirements in Rule [2711]2240(h)[(13)].

(H) For the purposes of the exemption in paragraph (f), the terms “affiliate,” “globally.[-]branded research report” and “mixed-team research report” shall have the following meanings:

(i) “Affiliate” shall mean a person that directly or indirectly controls, is controlled by, or is under common control with, a member.

(ii) “Globally.[-]branded research report” refers to the use of a single marketing identity that encompasses the member and one or more of its affiliates.

(iii) “Mixed-team research report” refers to any member research report that is not globally.[-]branded and includes a contribution by a research analyst who is not an associated person of the member.

FINRA Rule 2240. Research Analysts and Research Reports²

(a) Definitions

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

(1) “Equity security” has the same meaning as defined in Section 3(a)(11) of the Exchange Act.

(2) “Independent third-party research report” means a third-party research report, in respect of which the person producing the report:

(A) has no affiliation or business or contractual relationship with the distributing member or that member’s affiliates that is reasonably likely to inform the content of its research reports; and

(B) makes content determinations without any input from the distributing member or that member’s affiliates.

(3) “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.

(4) “Investment banking services” include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.

(5) “Member of a research analyst’s household” means any individual whose principal residence is the same as the research analyst’s principal residence. This term does not include an unrelated person who shares the same residence as a research analyst, provided that the research analyst and unrelated person are financially independent of one another.

² The proposal would delete NASD Rule 2711 and the corresponding provisions of Incorporated NYSE Rules 351, 472 and Rule Interpretation 472.

(6) “Public appearance” means any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons or before one or more representatives of the media, a radio, television or print media interview, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security. This term does not include a password protected Webcast, conference call or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading or no longer applicable.

(7) “Research analyst” means an associated person who is primarily responsible for, and any associated person who reports directly or indirectly to 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.”

(8) “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. This term shall not include an investment company registered under the Investment Company Act of 1940 over which the research analyst or a member of the research analyst’s household has discretion or control, provided that the research analyst or member of a research analyst’s household has no financial interest in such investment company, other than a performance or management fee. The term also shall 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.

(9) “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.

(10) "Research report" means any written (including electronic) communication that includes an analysis of equity securities of individual companies or industries (other than an open-end registered investment company that is not listed or traded on an exchange or a public direct participation program) and that provides information reasonably sufficient upon which to base an investment decision. This term does not include:

(A) communications that are limited to the following:

(i) discussions of broad-based indices;

(ii) commentaries on economic, political or market conditions;

(iii) technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price;

(iv) statistical summaries of multiple companies' financial data, including listings of current ratings;

(v) recommendations regarding increasing or decreasing holdings in particular industries or sectors; or

(vi) notices of ratings or price target changes, provided that the member simultaneously directs the readers of the notice to the most recent research report on the subject company that includes all current applicable disclosures required by this Rule and that such research report does not contain materially misleading disclosures, including disclosures that are outdated or no longer applicable;

(B) the following communications, even if they include an analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision:

(i) any communication distributed to fewer than 15 persons;

(ii) periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients 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; or

(iii) internal communications that are not given to current or prospective customers; and

(C) communications that constitute statutory prospectuses that are filed as part of a registration statement.

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

(12) "Third-party research report" means a research report that is produced by a person or entity other than the member.

(b) Identifying and Managing Conflicts of Interest

(1) A member must establish, maintain and enforce policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to:

- (A) the preparation, content and distribution of research reports; and
- (B) public appearances by research analysts.

(2) A member's policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member or certain current or prospective clients. Such policies and procedures must at a minimum:

(A) prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel;

(B) limit supervision and determination of compensation of research analysts to persons not engaged in investment banking services activities;

(C) prohibit compensation based upon specific investment banking services transactions or contributions to a member's investment banking services activities;

(D) require that the compensation of a research analyst who is primarily responsible for the substance of a research report be reviewed and approved at least annually by a committee that reports to a member's board of directors, or if the member has no board of directors, a senior executive officer of the member. This committee may not have representation from the member's investment banking department and must consider the following factors when reviewing a research analyst's compensation:

- (i) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;
- (ii) the correlation between the research analyst's recommendations and the stock price performance; and
- (iii) the overall ratings received from clients, sales force and peers independent of the member's investment banking department, and other independent ratings services.

The committee must document the basis upon which each such research analyst's compensation was established.

(E) establish information barriers and other institutional safeguards to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision;

(F) prevent direct or indirect retaliation or threat of retaliation against research analysts by persons engaged in investment banking services activities or other employees as the result of content of a research report;

(G) define periods of a minimum of 10 days after the completion of an initial public offering during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer if the member has participated as an underwriter or dealer in the offering;

(H) restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst, including:

(i) ensuring that research analyst accounts, supervisors of research analysts and associated persons with the ability to influence the content of research reports do not benefit in their trading from knowledge of the content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report; and

(ii) defining financial hardship circumstances, if any, in which the member will permit research analyst accounts to trade against their recommendations;

(I) prohibit explicit or implicit promises of favorable research, a particular research rating or recommendation or specific research content as inducement for the receipt of business or compensation;

(J) restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity, including prohibiting:

(i) participation in the solicitation of investment banking services; and

(ii) participation in road shows and other marketing on behalf of issuers; and

(K) prohibit prepublication review of a research report by a subject company for purposes other than verification of facts.

(c) Content and Disclosure in Research Reports

(1) A member must ensure that purported facts in its research reports are based on reliable information.

(2) A member must ensure that any recommendation, rating or price target has a reasonable basis in fact and is accompanied by a clear explanation of the valuation method utilized and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.

(3) A member that employs a rating system must clearly define in each research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based.

(A) Irrespective of the rating system a member employs, a member must include in each research report that includes a rating the percentage of all securities rated by the member to which the member would assign a “buy”, “hold” or “sell” rating.

(B) A member must disclose in each research report the percentage of subject companies within each of the “buy”, “hold” and “sell” categories for which the member has provided investment banking services within the previous 12 months.

(C) The information required in paragraphs (c)(3)(A) and (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 of the research report is less than 15 calendar days after the most recent calendar quarter.

(4) If a research report contains either a rating or price target for a subject company’s security, and the member has assigned a rating or price target to the security for at least one year, the research report must include a line graph of the security’s daily closing prices for the period that the member has assigned any rating or price target or for a three-year period, whichever is shorter. The graph must:

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

(B) depict each rating or 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 of the research report is less than 15 calendar days after the most recent calendar quarter).

(5) A member must disclose in any research report all conflicts that reasonably could be expected to influence the objectivity of the research report and that are known or should have been known by the member or research analyst on the date of publication or distribution of the report, including:

- (A) if the research analyst or a member of the research analyst's household has a financial interest in the debt or equity securities of the subject company, and the nature of such interest;
- (B) if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;
- (C) if the member or any of its affiliates:
 - (i) managed or co-managed a public offering of securities for the subject company in the past 12 months;
 - (ii) received compensation for investment banking services from the subject company in the past 12 months; or
 - (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;
- (D) if, as of the end of the month immediately preceding the date of publication or distribution of a 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) the member or its affiliates has received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;
- (E) if the subject company is, or over the 12 month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services.
- (F) if the member or its affiliates maintain a significant financial interest in the debt or equity of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;
- (G) if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report; and
- (H) any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.

(6) A member or research analyst will not be required to make a disclosure required by paragraph (c)(5) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(7) Except as provided in subparagraph (8), the disclosures required by this paragraph (c) must be presented on the front page of research reports or the front page must refer to the page on which the disclosures are found. Electronic research reports may provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by this Rule must be clear, comprehensive and prominent.

(8) A member that distributes a research report covering six or more subject companies (a “compendium report”) may direct the reader in a clear manner as to where the reader may obtain applicable current disclosures required by this paragraph (c). Electronic compendium reports may include a hyperlink to the required disclosures. Paper-based compendium reports must provide either a toll-free number to call or a postal address to write for the required disclosures and may also include a web address of the member where the disclosures can be found.

(d) Disclosure in Public Appearances

A research analyst must disclose in public appearances:

(1) if the research analyst or a member of the research analyst’s household has a financial interest in the debt or equity securities of the subject company, and the nature of such interest;

(2) if the member or its affiliates maintain a significant financial interest in the debt or equity of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company;

(3) 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 previous 12 months;

(4) if the research analyst received any compensation from the subject company in the previous 12 months;

(5) 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 publication or 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; or

(6) any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance.

(7) A member or research analyst will not be required to make a disclosure required by this paragraph (d) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

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

(e) Disclosure Required by Other Provisions

In addition to the disclosures required by paragraphs (c) and (d), members and research analysts must comply with all applicable disclosure provisions of NASD Rule 2210 and the federal securities laws.

(f) Termination of Coverage

A member must promptly notify its customers if it intends to terminate coverage of a subject company. Such notice must be made using the member's ordinary means of dissemination to its various customers. The notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a member must disclose to its customers its reason for terminating coverage.

(g) Distribution of Member Research Reports

A member must establish, maintain and enforce policies and procedures reasonably designed to ensure that a research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that are entitled to receive the research report.

(h) Distribution of Third-Party Research Reports

(1) A member must establish, maintain and enforce policies and procedures reasonably designed to ensure that any third-party research it distributes:

(A) is reliable and objective;

(B) contains complete and accurate disclosures, as applicable to the distributing member pursuant to paragraph (h)(2); and

(C) contains no untrue statement of material fact and is otherwise not false or misleading. For the purposes of this paragraph (h)(1)(C) only, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading information that:

(i) should be known from reading the report; or

(ii) is known based on information otherwise possessed by the member.

(2) A member must accompany any third-party research report it distributes with, or provide a web address that directs a recipient to, disclosure of any material conflict of interest that can reasonably be expected to have influenced the choice of a third party research provider or the subject company of a third-party research report.

(3) A member shall not be required to review a third-party research report to determine compliance with paragraph (h)(1)(C) if such research report is an independent third-party research report.

(4) For the purposes of paragraph (h)(2), a member shall not be considered to have distributed independent third-party research where such research is made available by a member

(a) upon request;

(b) through a member-maintained web site; or

(c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

(5) A member must ensure that a third-party research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the research report.

(i) Exemption for Members with Limited Investment Banking Activity

The provisions of paragraphs (b)(2)(A), (B), (D) and (E) 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 revenues from those transactions; provided, however, that with respect to paragraph (b)(2)(E), such members must establish information barriers and other institutional safeguards to ensure research analysts are insulated from pressure by persons engaged in investment banking services activities or other persons who might be biased in their judgment or supervision. For the purposes of this paragraph (i), 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 sufficient to establish eligibility for the exemption and also maintain for at least three years any communication that, but for this exemption, would be subject to paragraphs (b)(2)(A), (B), (D) and (E).

••••• **Supplementary Material:** —————

.01 Pitch Book Materials. FINRA interprets paragraph (b)(2)(J)(i) to prohibit in pitch materials any information about a member's research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage. For example, FINRA would consider the publication in a pitch book or related materials of an analyst's industry ranking to imply the potential outcome of future research because of the manner in which such rankings are compiled. On the other hand, a member would be permitted to include in the pitch materials the fact of coverage and the name of the research analyst because such information alone does not imply favorable coverage.

Members must consider whether the facts and circumstances of any solicitation or engagement would warrant disclosure under Section 17(b) of the Securities Act of 1933.

.02 Disclosure of Non-Investment Banking Services Compensation. A member may satisfy the disclosure requirement in paragraph (c)(5)(D) with respect to receipt of non-investment banking services compensation by an affiliate by implementing policies and procedures reasonably designed to prevent the research analyst and associated persons of the member with the ability to influence the content of research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation. However, a member must disclose receipt of non-investment banking services compensation received by its affiliates from the subject company in the past 12 months when the research analyst or an associated person with the ability to influence the content of a research report has actual knowledge that an affiliate received such compensation during that time period.

.03 Beneficial Ownership of Equity Securities. With respect to paragraphs (c)(5)(F) and (d)(2), beneficial ownership of any class of common equity securities shall be computed in accordance with the same standards used to compute ownership for purposes of the reporting requirements under Section 13(d) of the Exchange Act.

.04 Distribution of Member Research Products. With respect to paragraph (g), a member may provide different research products and services to certain classes of customers. For example, a member may offer one research product for those with a long-term investment horizon (“investor research”) and a different research product for those customers with a short-term investment horizon (“trading research”). These products may lead to different recommendations or ratings, provided that each is consistent with the meaning of the member’s ratings system for each respective product. However, a member may not differentiate a research product based on the timing of receipt of a recommendation, rating or other potentially market moving information, nor may a member denote a research product as one product as a means to allow certain customers to trade in advance of other customers that are entitled to the same research product. In addition, a member that provides different research products and services for certain customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research.

.05 Ability to Influence the Content of a Research Report. For the purposes of this Rule, an associated person with the ability to influence the content of a research report is an associated person who, in the ordinary course of that person’s duties, has the authority to review the research report and change that research report prior to publication or distribution.