

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57278; File No. SR-FINRA-2007-010)

February 6, 2008

Self-Regulatory Organizations: Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment No. 1 to Amend an Exemption to NASD Rule 1050 and NYSE Rule Interpretation 344/02 for Certain Research Analysts Employed By a Member's Foreign Affiliate Who Contribute to the Preparation of a Member's Research Report.

I. Introduction

On September 12, 2007, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² Notice of the proposal was published for comment in the Federal Register on September 26, 2007.³ The Commission received two comment letters in response to the proposed rule change.⁴ On January 16, 2008, FINRA filed Amendment No. 1 to the proposed rule change to make certain modifications to the original rule filing. This order provides notice of the proposed rule change, as modified by Amendment No. 1, and approves the proposed rule change as amended on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 56481 (September 20, 2007), 72 FR 54700 (September 26, 2007).

⁴ Securities Industry and Financial Markets Association ("SIFMA") letter dated October 17, 2007; and WilmerHale ("WilmerHale") letter dated October 19, 2007 on behalf of Credit Suisse Securities (USA), LLC; Goldman, Sachs & Co.; J.P. Morgan Securities Inc.; Lehman Brothers Inc.; Merrill Lynch, Pierce, Fenner & Smith Incorporated; and UBS Securities LLC.

II. Description

On September 12, 2007, FINRA filed with the Commission a proposed rule change to amend an exemption to NASD Rule 1050 and New York Stock Exchange (“NYSE”) Rule Interpretation 344/02 for certain research analysts employed by a member’s foreign affiliate who contribute to the preparation of a member’s research report. The Commission received two comment letters concerning the proposed rule change.⁵ FINRA responded to those comments in a letter dated January 16, 2008.⁶ In accordance with that response to comments, FINRA amended the proposed rule change.

NASD Rule 1050 and NYSE 344 (“Rules”) require an associated person who functions as a research analyst to register as such with FINRA and pass a qualification examination (the Series 86/87). The Rules currently provide a number of exemptions from the Series 86 examination, including certain research analysts who are employed by a member’s foreign affiliate and contribute to the preparation of a member’s research report. The proposed rule change would modify this exemption.

A. Current Exemption

FINRA and the NYSE consider a “research report” to be attributable to the member if (1) the report appears to be the product of the member or (2) a “research analyst” (as defined by FINRA rules) associated with a member is involved in producing the research report.⁷ If either of these factors are present, the research report and any

⁵ Id.

⁶ The comments and responses thereto are discussed in greater detail in FINRA’s Response to Comments. See letter from Philip Shaikun to Nancy M. Morris dated January 16, 2008.

⁷ See NASD Notice to Members 04-18 and NYSE Information Memo 04-10. The New York Stock Exchange memo applies to its Rule 472. FINRA has incorporated both Rule 472 and the applicable interpretive guidance.

“research analyst” involved in its production must meet all of the applicable requirements of NASD Rules 1050 and 2711 and NYSE Rules 344 and 472.

Since the Rules require any “research analyst” who contributes to the preparation of a member’s research report or whose name appears on such report to be registered, certain foreign analysts who contribute to the production of a member’s “globally-branded” research or “mixed-team” research report could be required to meet the qualification requirements, but only if they are associated persons of the member.⁸ Thus, FINRA proposed an exemption from the research analyst qualification requirements for certain research analysts employed by foreign entities in certain jurisdictions approved by FINRA and the NYSE, and subject to certain conditions. The Commission approved the proposed exemption in May 2005.⁹

Current exemptive relief for foreign analysts from the registration and qualification provisions requires compliance with other standards in foreign jurisdictions that reflect a recognition of principles that are consonant with FINRA qualification standards and the research analyst conflict of interest rules. Foreign research analysts in jurisdictions that do not have approved standards are still required to pass the Series 86 and 87 examinations if they are "associated persons" and participate in the preparation of a member's research report.

B. Amended Proposal

The proposed rule change would create a superseding exemption from the research analyst qualification requirements that would cover research analysts residing

⁸ FINRA Notice to Members 04-25 (March 2004).

⁹ See Securities Exchange Act Release No. 51644 (May 2, 2005), 70 FR 24148 (May 6, 2005) (File No. SR-NYSE 2005-25 and SR-NASD-2005-043).

anywhere outside of the United States. More specifically, the requirements of NASD Rule 1050(a) and NYSE Rule 344.10 would 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.¹⁰ Eligibility for the exemption would further be conditioned on the member meeting certain supervisory, disclosure and recordkeeping requirements.

C. Supervisory Requirement

Members that publish or otherwise distribute globally-branded research reports partially or entirely prepared by a foreign research analyst would be required to subject such research to pre-use review and approval by a registered principal or supervisory analyst in accordance with NASD Rule 1022(a)(5) and NYSE Rule 344.11 and interpretations thereto.¹¹ In addition, the member would be required to ensure that such research reports comply with NASD Rule 2711 and NYSE Rule 472, as applicable.

D. Disclosure Requirement

In publishing or otherwise distributing globally-branded research reports partially or entirely prepared by a foreign research analyst, a member would be required to prominently disclose on the research report (1) each affiliate contributing to the research report, (2) the names of the foreign research analysts employed by each contributing affiliate, (3) that such research analysts are not registered/qualified as research analysts

¹⁰ When used in reference to NYSE Rule 344.10, the term “member” refers to both a natural person and “member organization.”

¹¹ See NASD Notice to Members 04-81 and 07-04.

with FINRA, and (4) that such research analysts may not be associated persons of the member and therefore may not be subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. The amended proposal, as discussed below, would require that this disclosure 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. For electronic research reports, a member could hyperlink to the disclosure.

E. Recordkeeping Requirement

Members would be required to establish and maintain records that identify those individuals who have availed themselves of the exemption, the basis for such exemption, and evidence of compliance with the conditions of the exemption. Failure to establish and maintain such records would create an inference of a violation of NASD Rule 1050 and NYSE Rule 344. Members also would be required to establish and maintain records that evidence compliance with the applicable content, disclosure, and supervision provisions of NASD Rule 2711 and NYSE Rule 472. Members must maintain these records in accordance with the supervisory requirements of NYSE Rule 342 and NASD Rule 3010, and in addition to such requirement, the failure to establish and maintain such records would create an inference of a violation of the applicable content, disclosure, and supervision provisions of NYSE Rule 472 and NASD Rule 2711.

The proposed rule change would have no impact on 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 self-regulatory organization rules. And the fact that a foreign research analyst avails herself or himself of this exemption would not be probative of whether that individual is an “associated

person” for other purposes, including whether the foreign research analyst is subject to the NASD Rule 2711 and NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

As noted in the original filing, the proposed rule change would apply prospectively only and is not intended to abate any enforcement actions for failure to comply with the existing exemption. FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be the date of publication of the Regulatory Notice announcing Commission approval.

III. Comment Letters

The Commission received two comment letters in response to the proposed rule change.¹² Both commenters objected to the requirement that the proposed disclosures that are a condition for the exemption for foreign research analysts appear on the front page of the research report as originally proposed by FINRA. The commenters noted that, with respect to other important disclosures required by current NASD research analyst conflict of interest rules, FINRA permits members to direct investors in a clear and prominent manner on the front page of the report to the page where the disclosures can be found. And with respect to electronic research reports, members may provide a hyperlink to the disclosures. The commenters argued that the same standard should apply with respect to the disclosures required as a condition of the proposed exemption from the research analyst registration and qualification requirements.

FINRA agreed that the disclosures required by the proposed exemption should be treated in the same manner as existing disclosures required by NASD Rule 2711 and

¹² See supra note 4.

NYSE Rule 472 and therefore amended the proposed rule change with Amendment No. 1. The amended rule text would provide that the disclosures required under the foreign analyst exemption 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 could hyperlink to the disclosures. All references and disclosures would be required to be clear, comprehensive and prominent.

Both commenters also objected to the provision of the rule which would create an inference of a violation if the records required to be kept to be able to rely on the exception are not maintained by the member. The commenters believe that it would be unfair that a failure to maintain the records in support of an exemption should infer a violation of the substantive underlying rules, particularly where the failure may be accidental. FINRA responded that it believes that the inference language is necessary because much of the documentation (and potential testimonial evidence) needed by FINRA to establish a violation of the underlying rules likely resides with entities or individuals that may be beyond FINRA's jurisdiction and thus may be the only means for FINRA to enforce the conditions of the exception. FINRA further asserted that an inference does not shift the burden of proof in an enforcement case and would simply permit (not compel) a trier of fact to infer from the lack of documentation that certain facts probative of whether a violation of the underlying rule has occurred.

One commenter sought clarification on two points.¹³ The commenter asked whether a globally-branded (but mixed-team) research report qualifies for the exception if all of the conditions are met. FINRA has stated that it would, but a mixed-team report that is not globally-branded would not be eligible for the exception. The commenter also

¹³ WilmerHale.

asked whether a member that distributes a globally-branded research report of its foreign affiliates may treat such as third-party research in accordance with NASD Rule 2711(h)(13) and NYSE Rule 472(k)(4). FINRA responded that a globally-branded research report is considered to be a member's research report (and therefore subject to all of the provisions of NASD Rule 2711 and NYSE Rule 472) unless the member makes it clear and unambiguous to recipients that the research being distributed is wholly the product of a third party.¹⁴ The fact that a member avails itself of the proposed exemption from the registration requirements of NASD Rule 1050 and NYSE Rule Interpretation 344/02 in connection with a particular globally-branded research report has no bearing on whether the research report is considered third-party research for purposes of NASD Rule 2711 and NYSE Rule 472. Thus, if the member is not extremely clear in identifying the report as being the product solely of its foreign affiliate, FINRA will continue to treat the research report as being that of the member, rather than third-party research.

IV. Discussion

The Commission has carefully reviewed the proposed rule change and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.¹⁵ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,¹⁶ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in

¹⁴ NASD and NYSE Joint Memorandum, NASD Notice to Members 04-18 and NYSE Information Memo 04-10 (March 2004).

¹⁵ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁶ 15 U.S.C. 78o-3(b)(6).

general, to protect investors and the public interest. The Commission believes that the proposed rule change will promote dissemination of globally-branded and foreign research to investors and ensure that such research has investor protection safeguards that might not otherwise be required.

The Commission also finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing of the amendment in the Federal Register. The proposed rule change was published in the Federal Register on September 26, 2007.¹⁷ FINRA submitted Amendment No. 1 in response to comments received on the proposed rule change. The Commission believes that Amendment No. 1 simplifies the obligations of FINRA member firms but not at the expense of investor protection. Amendment No. 1 does not contain major modifications that are more restrictive than the scope of the proposed rule change as published in the Federal Register. The Commission believes that approving Amendment No. 1 will simplify compliance, and is consistent with the public interest and the investor protection goals of the Act. Finally, the Commission finds that it is in the public interest to approve the proposed rule change as soon as possible to expedite its implementation.

Accordingly, the Commission believes good cause exists, consistent with Sections 15A(b)(6) and 19(b) of the Act,¹⁸ to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments

¹⁷ See supra note 3.

¹⁸ 15 U.S.C. 78o-3(b)(6), and 78s(b).

concerning the foregoing, including whether the proposed rule changes are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2007-010 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2007-010. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the

Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2007-010 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 15A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (File No. SR-FINRA-2007-010), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Florence E. Harmon
Deputy Secretary

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).