

Notice to Members

MAY 2005

SUGGESTED ROUTING

Executive Representatives
Investment Banking
Legal & Compliance
Operations
Research
Senior Management

KEY TOPICS

Communications with the Public
Investment Banking
Research Analysts

GUIDANCE

Research Analysts and Research Reports

SEC Approves Amendments to Rule 2711 to Prohibit Research Analysts from Participating in a Road Show and from Communicating with Customers in the Presence of Investment Banking Personnel or Company Management about an Investment Banking Services Transaction;
Compliance Date: June 6, 2005

Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to Rule 2711 (Research Analysts and Research Reports) to further insulate research analysts from the potential influences of the investment banking department. The amendments prohibit (1) a research analyst from participating in a road show related to an investment banking services transaction and from 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 and (2) investment banking department personnel from directing a research analyst to engage in sales and marketing efforts and other communications with a customer about an investment banking services transaction. The proposed rule change expressly permits analysts to educate investors and internal personnel about an investment banking services transaction, provided such communications are "fair, balanced and not misleading."

The new rule can be found in Attachment A of this *Notice* and becomes effective on **June 6, 2005**.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202)-728-8451.

Background and Discussion

During the past few years, NASD has implemented a series of rules to increase the objectivity and reliability of research. While the rules generally foster objectivity through extensive conflict of interest disclosure requirements, they also prohibit certain conduct to minimize the primary source of biased research: the influences of investment banking. To that end, NASD Rule 2711 prohibits compensation paid to analysts based on their contributions to, or the success of, the investment banking department. The rule further prohibits analysts from participating in efforts to solicit investment banking business, including “pitches” to earn an underwriting mandate for a securities offering.

The new rule fortifies the wall between investment banking and research by prohibiting 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. Additionally, the rule 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 analyst participation in road shows and from communicating with customers in the presence of investment bankers or company management, the rule will further reduce pressure on research analysts to give an overly optimistic assessment of a particular transaction. It also will remove 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.

The rule 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 the company or 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. Thus, the rule preserves the ability of the research analyst to give a candid assessment of a transaction or sale of securities—including investment risks—in settings where the influences of investment banking and client pressure are minimized.

Finally, the rule prohibits investment banking department personnel from directing a research analyst to engage in sales or marketing efforts and any other communication with a current or prospective customer about an investment banking services transaction. This provision eliminates any attempt by investment banking personnel to pressure a research analyst to engage in otherwise permissible communications, thereby further insulating research analysts from influences that could affect their objectivity.

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ATTACHMENT A

New language is underlined; deletions are in brackets.]

Rule 2711. Research Analysts and Research Report

(a) through (b) No change.

(c) Restrictions on Communications with the Subject Company

(1) through (4) No change.

(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) through (k) No change.