

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 242

[Release Nos. 33–8119; 34–46301; File No. S7–30–02]

RIN 3235–A160

### Regulation Analyst Certification

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Commission is seeking public comment on proposed Regulation Analyst Certification. The proposed regulation would require that any research report disseminated by broker or dealer include certifications by the research analyst that the views expressed in the research report accurately reflect the analyst's personal views, and whether the analyst received compensation or other payments in connection with his or her specific recommendations or views. A research analyst would also be required to provide certifications and disclosures in connection with public appearances. Although research analysts are often viewed by investors as experts and as important sources of information about the securities and companies they cover, many factors can create pressure on their independence and objectivity. By requiring these certifications and disclosures, the proposed regulation should promote the integrity of research reports and investor confidence in the recommendations contained in those reports.

**DATES:** Comments must be received on or before September 23, 2002.

**ADDRESSES:** To help us process and review your comments more efficiently, comments should be sent by one method only.

Persons wishing to submit written comments should send three copies to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. S7–30–02. Comments submitted by E-mail should include this file number in the subject line. Comment letters received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters will be posted on the Commission's Internet Web site (<http://www.sec.gov>). The Commission does not

edit personal, identifying information, such as names or e-mail addresses, from electronic submissions. Submit only the information you wish to make publicly available.

#### FOR FURTHER INFORMATION CONTACT:

James Brigagliano, Thomas Eidt, or Racquel Russell in the Office of Risk Management and Control, Division of Market Regulation, at (202) 942–0772.

**SUPPLEMENTARY INFORMATION:** We are proposing new Regulation Analyst Certification ("Regulation AC")<sup>1</sup> under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").

### I. Introduction

Research analysts study publicly-traded companies and make recommendations about the securities of those companies, often through the issuance of research reports. Analysts typically work for full-service broker-dealers<sup>2</sup> and, as such, are "persons associated with a broker or dealer."<sup>3</sup> The Commission has stated that analysts, who "ferret out and analyze information," play an important role in the securities markets.<sup>4</sup>

Research analysts at full-service brokerage firms, so called sell-side analysts, are often viewed by investors as experts and as important sources of information about the securities and the companies they cover.<sup>5</sup> At the same time, however, many factors can create pressure on an analyst's independence and objectivity. Among other things, investment banking relationships and certain compensation arrangements may adversely affect analyst objectivity and, as a result, the integrity of the views expressed in research reports and public appearances.

Proposed Regulation AC seeks to address these concerns by requiring broker-dealers issuing research reports to include clear and prominent certifications by the research analysts that the research report accurately reflects the analyst's personal views about the subject securities and issuers and whether the analyst received

compensation for views or specific recommendations in the research report. The proposed regulation would also require the analyst to make quarterly certifications that the views expressed by the analyst in public appearances accurately reflected the analyst's personal views and whether or not he or she received any related compensation for his or her views or recommendations. In so doing, the proposed regulation should promote the integrity of research reports and investor confidence in the research analyst's recommendations contained in those reports.

### II. Proposed Rule

#### A. Reasons for Proposal

During 1999, the Commission and Congress began to examine research analysts' conflicts of interest in greater depth. The Commission was particularly concerned that many investors who rely on analysts' recommendations may not know, among other things, that favorable research could be used as a component of the marketing of investment banking services provided by the analyst's firm, and that analyst compensation may be based significantly on generating investment banking business.

Beginning in the summer of 1999, Commission staff began a review of industry practices regarding disclosure of research analyst conflicts of interest. Commission staff conducted on-site examinations of full-service broker-dealers that focused on analysts' financial interests in companies they cover, reporting structures (in particular whether analysts report to investment banking personnel) and analyst compensation arrangements. In June and July 2001, the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House of Representatives' Committee on Financial Services held hearings on research analyst conflict of interest issues.<sup>6</sup> In addition, also in July 2001, the staff of the Commission's Office of Investor Education and Assistance issued an Investor Alert highlighting the numerous biases that may affect analyst recommendations.<sup>7</sup> The Senate Committee on Governmental Affairs held a hearing on analysts on February 27, 2002.<sup>8</sup>

<sup>6</sup> *Analyzing the Analysts: Hearings Before the Subcomm. on Capital Markets Insurance and Government Sponsored Enterprises of the House Comm. on Financial Services* (June 14 and July 31, 2001).

<sup>7</sup> See [www.sec.gov/investor/pubs/analysts.htm](http://www.sec.gov/investor/pubs/analysts.htm).

<sup>8</sup> *The Watchdogs Didn't Bark: Enron and the Wall Street Analysts: Hearing Before the Senate Comm. on Governmental Affairs* (February 27, 2002).

<sup>1</sup> 17 CFR 242.500 through 502.

<sup>2</sup> Full-service broker-dealers provide a wide range of services to clients, including investment banking, financial planning, and other financial services.

<sup>3</sup> See Exchange Act Section 3(a)(18).

<sup>4</sup> *Dirks v. SEC*, 463 U.S. 646, 658 (1983). See also Securities Act Release No. 7606A (November 13, 1998), 63 FR 67174 (December 4, 1998).

<sup>5</sup> Sell-side analysts typically work for full-service broker-dealers that sell securities to the public and make recommendations on the securities they cover. Many of the more popular sell-side analysts work for prominent brokerage firms that also provide investment banking services for corporate clients—including companies whose securities the analysts cover.

On April 25, 2002, the Commission announced the commencement of a formal inquiry into market practices concerning research analysts and the personal conflicts that can arise from the relationship between research and investment banking.<sup>9</sup> Further, on May 10, 2002, the Commission approved rule changes proposed by the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE") relating to research analyst conflicts of interest.<sup>10</sup> The NASD and NYSE filed these rule changes with the Commission in February 2002. New NASD Rule 2711 and amended NYSE Rule 472 established standards governing member broker-dealer communications with the public to address research analyst conflicts of interest. Specifically, the rules contain, among other things:

- A prohibition on tying analyst compensation to specific investment banking transactions;
- A prohibition on offering favorable research to induce firm business;
- Restrictions on personal trading by analysts in securities of companies followed by the analyst; and
- Requirements mandating increased disclosures of conflicts of interest in research reports and public appearances, such as business relationships with, compensation from, or ownership interests in the company that is the subject of the research report.

New NASD Rule 2711 and amended NYSE Rule 472 also require that members attest annually that the member has adopted and implemented written supervisory procedures reasonably designed to ensure that employees comply with the provisions of the rule. These SRO rules close regulatory gaps and take a significant step toward restoring investor confidence in the role of sell-side research in the capital markets. However, it is possible that the Commission's formal inquiry may indicate the need for further SRO rule changes or additional Commission action. Moreover, the Commission has requested that the NASD and NYSE report within a year of implementing these rules on their operation and effectiveness, and whether they recommend any changes or additions to the rules.

Proposed Regulation AC is part of an ongoing process by the Commission to address conflicts of interest affecting the production and dissemination of research by securities firms, and to

provide increased disclosure to investors. The Commission encourages brokers, dealers, and persons associated with brokers and dealers, to consider voluntarily implementing the types of disclosures that proposed Regulation AC, if adopted, would require. The Commission will continue its efforts to determine whether any additional action may be necessary to improve the integrity of research and to restore investor confidence.<sup>11</sup>

#### *B. Description of Proposal*

We propose new Regulation AC to further address conflicts of interest faced by research analysts and their firms. The proposed regulation would require certification by "research analysts" that the views they express in "research reports" and "public appearances" accurately reflect their personal views about the subject securities and issuers. Analysts would also have to disclose whether they received compensation for their specific recommendations or views. The proposed regulation defines "research report" as "a written communication that includes an analysis of securities of an issuer or issuers, provides information reasonably sufficient upon which to base an investment decision and includes a recommendation." Proposed Regulation AC requires certain certifications and disclosures regarding a "public appearance," which is defined 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 specific recommendation or offers an opinion concerning a security or an issuer." "Research analyst" is defined as "any natural person who is principally responsible for the analysis of any security or issuer included in a research report."

Proposed Regulation AC would require that broker-dealers and persons associated with broker-dealers include in their research reports:

- A statement by the research analyst certifying that the views expressed in the research report accurately reflect such research analyst's personal views about the subject securities and issuers;

- A statement by the research analyst certifying that no part of his or her compensation<sup>12</sup> was, is, or will be directly or indirectly related to the specific recommendation or views contained in the research report; or

- A statement by the research analyst certifying that part or all of his or her compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in the research report. If the analyst did receive such related compensation, the statement must include the source and amount of such compensation, and the purpose of the compensation, and further disclose that such compensation may influence the recommendation in the research report;

- All certifications must be clear and prominent.<sup>13</sup>

Additionally, under proposed Regulation AC, broker-dealers must make a record related to public appearances by research analysts.<sup>14</sup> Specifically, a broker-dealer who publishes, circulates, or provides, directly or indirectly, a research report by a research analyst, would be required to make a record within thirty days after each calendar quarter in which the research analyst made the public appearance, that includes:

- A written statement by the research analyst certifying that the views expressed in each public appearance accurately reflected such research analyst's personal views about the subject securities and issuers; and
- A written statement by the research analyst certifying that no part of such research analyst's compensation was, is, or will be directly or indirectly related to any specific recommendations or views expressed in any public appearance.

In cases where the analyst is unable to make the certifications in connection with public appearances as described above, the broker-dealer must make, keep, and maintain a record of a statement from the research analyst that he or she is unable to provide the written certifications specified in Rule 502 (a)(1) of proposed Regulation AC

<sup>12</sup> The Commission notes that the term "compensation," for the purposes of Regulation AC, would also include payments received from sources other than the research analyst's employer, including issuers, underwriters, dealers, and other related persons.

<sup>13</sup> The Commission would expect that the required certifications be included on the front page of the research report, or that the front page would specify the page or pages on which each certification is found.

<sup>14</sup> If an associated person of a broker-dealer publishes a research report, the broker-dealer would be required to make and keep the mandated records.

<sup>9</sup> See [www.sec.gov/news/press/2002-56.htm](http://www.sec.gov/news/press/2002-56.htm).

<sup>10</sup> See Securities Exchange Act Release No. 45908 (May 10, 2002), 67 FR 34968 (May 16, 2002).

<sup>11</sup> We note that the recently-enacted Sarbanes-Oxley Act of 2002 directs the Commission to conduct rulemaking, itself or through the SROs, to address a broad range of issues stemming from analysts conflicts. See Sarbanes-Oxley Act of 2002, Public Law 107-204. The Commission voted to propose Regulation AC on July 24, 2002, before the passage of the Act. The Commission will, of course, abide by the directives of the Act as it continues to address analyst conflicts of interest issues, including with respect to the possible adoption of Regulation AC.

and the reasons therefor. The broker-dealer must also disclose in all research reports for the next 120 days that the research analyst did not comply with the certification requirements specified in Rule 502 (a)(1) of proposed Regulation AC and the reasons therefor. It should be noted that the 120 day disclosure period prescribed in paragraph (a)(2) of proposed Rule 502, which is longer than a calendar quarter, runs from the time the analyst notifies the broker-dealer employer that he or she is unable to provide the written certifications specified in paragraph (a)(1). The broker-dealer must also promptly provide copies of statements that the analyst is unable to provide the certifications in connection with public appearances to its examining authority, designated pursuant to section 17(d) of the Exchange Act and Rule 17d-2 thereunder. Further, broker-dealers must keep and maintain these records pursuant to Rule 17a-4(b)(4).

Proposed Regulation AC is intended to complement other rules governing conflicts of interest disclosure by research analysts, including NYSE Rule 472 and NASD Rule 2711. We note that SRO rules currently address an analyst who writes a research report that does not reflect his or her personal views, even if the analyst states that the report does not reflect his or her views. Thus, we do not see a need to allow for a negative certification concerning an analyst's personal views. Should Regulation AC also provide an analyst a negative certification option that the views expressed in the research report do not accurately reflect his or her personal views? Similarly, given that SRO rules currently prohibit an analyst from receiving compensation for a specific investment banking transaction, is it necessary or desirable for Regulation AC to permit an analyst to disclose the receipt of compensation for a specific recommendation?

The scope of proposed Regulation AC is broader than the scope of the current SRO rules in that the proposed regulation covers debt as well as equity securities. We believe that some of the same concerns regarding analyst conflicts also pertain to debt securities. Thus, we propose to cover debt securities in the regulation. In addition, we understand that the SROs are considering expanding the coverage of their rules regarding analyst research reports to cover debt securities.

Proposed Regulation AC focuses on core issues of analysts' integrity: their beliefs in their recommendations and the influence of compensation on their recommendations. It is important for an investor to know whether an analyst

potentially is biased with respect to securities or issuers that are the subject of a research report. Further, in evaluating a research report, it is reasonable for an investor to want to know about an analyst's compensation. We believe that proposed Regulation AC is reasonably designed to prevent acts and practices that are fraudulent, deceptive, or manipulative. The proposed regulation does not preclude an analyst from providing services to his or her firm's investment banking department within the requirements of governing SRO rules, and it does not prohibit analysts generally from receiving compensation for covering issuers or for preparing research reports. Rather, proposed Regulation AC focuses on disclosure where the analyst is compensated for making a specific recommendation or rating. The Commission also notes that the proposed regulation is intended to address analysts' beliefs about their expressed views and recommendations, not the accuracy of the recommendations or opinions regarding securities discussed. Proposed Regulation AC also does not impose new liability. Even without proposed Regulation AC, analysts may be found to have violated the anti-fraud provisions of the federal securities laws if they make baseless recommendations or recommendations that they disbelieve.<sup>15</sup> Regulation AC is not intended to create duties under section 10(b) of the Exchange Act. As a result, no private liability will arise from a broker, dealer, or associated person's failure to make the required disclosure, or make, keep, and maintain required records.

### III. General Request for Comment

We encourage any interested person to submit written comments on all aspects of the proposed regulation. In particular, we request comment on:

- Would the proposed certification and disclosure requirements, if adopted, promote investor confidence in the views expressed by research analysts and provide investors with useful information with which to evaluate potential biases?
- Would the required disclosures and certifications reduce public appearances by analysts and the amount of useful information available to investors?
- Should the proposed definitions of "research report," "research analyst," or "public appearance" be broader or narrower than proposed?<sup>16</sup>

<sup>15</sup> Regulation AC does not alter or effect any other existing obligation under the federal securities laws for research analysts or broker-dealers.

<sup>16</sup> For example, we note the term research analyst would not include an investment adviser, such as

- Should the proposed definition of "research report" be limited to cover only equity securities?

- What disclosures, if any, should be required during public appearances? We also request comment on whether the proposed requirements relating to public appearances should also apply to research analyst's recommendations in the print media.

- Broker-dealers often choose to publish research reports that cover multiple issuers, securities, or an industry segment, in a compendium report. Certain portions of the NASD and NYSE rules permit different treatment of these compendium reports. Should the regulation make allowances for compendium research reports covering six or more securities? For example, should a broker-dealer be permitted to publish the required disclosures for such a compendium in a place other than the research report?

- If a research analyst is unable to provide the certifications relating to public appearances in Rule 502(a)(1) and instead provides the certifications in Rule 502(a)(2), the broker-dealer is required to disclose that fact in all research reports for 120 days after the analyst has provided his or her certification under Rule 502(a)(2). Is 120 days the appropriate amount of time the broker-dealer should be required to make such disclosure? Should the disclosure period be longer or shorter?

- Are the recordkeeping requirements of Regulation AC appropriate?

- What additional procedures would firms need to put in place in order to ensure compliance with the proposed regulation, beyond those already established or that will be established to comply with the recently-approved SRO rules?

- The application of proposed Regulation AC broadly covers brokers or dealers and any person associated with a broker or dealer because we believe that these entities are subject to the greatest conflicts. We request comment on whether the proposed regulation should cover banks that are not associated persons and other independent entities. Are there certain classes of persons associated with a broker-dealer that should not be subject to the rule? Should the rule explicitly exclude investment advisers?

a mutual fund portfolio manager, who is not principally responsible for preparing research reports, even if the investment adviser is a registered person of a member. See Joint Memorandum of the 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) at 3.

- Would the required disclosures be utilized by investors if they are not on the cover page, given the numerous other disclosures that firms must make?

- Should Rule 501 of proposed Regulation AC allow for a statement that the research analyst is "unable to provide the written certifications required," similar to Rule 502?

- Should Rule 502 require research analysts to provide their employers with a list identifying each public appearance made during the calendar quarter?

We solicit comment on our approach and the specific proposed certifications and disclosures. The Commission encourages commenters to provide information regarding the advantages and disadvantages of the proposed regulation.

#### IV. Paperwork Reduction Act

The proposed regulation contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>17</sup> We will submit the proposal to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>18</sup> The Commission is proposing to create a new information collection entitled "Regulation AC—Analyst Certification." An agency may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid OMB control number.

##### A. Summary of Collection of Information

Proposed Regulation AC, if adopted, would require that any research report published, circulated, or provided by a broker or dealer or person associated with a broker or dealer contain a statement attesting to the fact that the views expressed in each research report accurately reflect the analyst's personal views and whether or not the research analyst received or will receive any compensation in connection with the views or recommendations in the research report. The proposed regulation would also require broker-dealers to, on a quarterly basis, make, keep, and maintain records of research analyst statements regarding whether the views expressed in public appearances accurately reflected the analyst's views, and whether any part of the analyst's compensation is related to the specific recommendation or views expressed in the public appearance.

##### B. Reporting and Cost Burden Estimates

The proposed regulation would provide that broker-dealers, and persons associated with broker-dealers, must include in research reports they publish certain certifications and disclosures about the analyst's views expressed in the research reports and any relationship between the analyst's compensation and the specific recommendations or views expressed. The proposed regulation would also require broker-dealers to make, keep, and maintain records of research analyst certifications and disclosures in connection with public appearances.

The staff of the Commission believes that the average amount of time it would take a broker-dealer to include the required certifications and disclosures in each research report is one minute per report. The Commission staff estimates that broker-dealers publish approximately 657,000 research reports per year.<sup>19</sup> Therefore, the Commission estimates that the total annual burden in hours for all broker-dealers to comply with the research report certification and disclosure requirements of the proposed regulation is approximately 10,950 hours per year [(1 minute × 657,000 reports) / 60 minutes]. The Commission staff expects that research analysts will likely be the employees primarily charged with executing certifications and including them in research reports. According to industry sources, research analysts, on average, earn \$189,250 per year, for an hourly pay rate of approximately \$90. Including 35% overhead, Commission staff estimates that the hourly pay rate for a research analyst would be approximately \$121.50. Therefore, the Commission estimates that the total annual burden in dollars of complying with the research report certification and disclosure requirements is approximately \$1,330,425 per year [10,950 hours × \$121.50 per hour].

The staff of the Commission believes that the average amount of time it would take a research analyst to prepare the quarterly statements regarding public appearances as required by the proposed regulation is ten minutes per analyst. The staff of the Commission believes that, on average, approximately 519 public appearances by research analysts occur per quarter,<sup>20</sup> or about 2,076 per year. Therefore, the

Commission believes that the total annual burden in hours of complying with the public appearance certification and disclosure requirements would be approximately 346 hours per year [(10 minutes × 2076 appearances) / 60 minutes].

In cases where the analyst is unable to make the certifications in connection with public appearances as specified in Rule 502 (a)(1) of proposed Regulation AC, the firm is required to make, keep, and maintain a record of a statement from the research analyst that he or she is unable to make the specified certifications, and the reasons therefor, and to provide copies of that statement to its examining authority. The staff of the Commission believes that there will be few, if any, instances where a broker-dealer will provide copies of statements to their examining authority, as analysts and their firms will have strong incentives to avoid having to make the type of disclosures required to be provided to their examining authority. Therefore, the total annual burden, in dollars, of complying with the public appearance certification requirements would be approximately \$42,039 [2,076 appearances × \$20.25 pay per 10 minutes].

The proposed regulation requires that the records of statements regarding public appearances submitted by research analysts to their broker-dealers be preserved in accordance with Exchange Act Rule 17a-4(b)(4). Exchange Act Rule 17a-4(b)(4) requires that any communication relating to a broker-dealer's business, including inter-office communications, must be kept for at least three years. In light of the existing record preservation requirement for brokers and dealers under Exchange Act Rule 17a-4(b)(4),<sup>21</sup> the staff of the Commission believes that any additional costs to preserve the records of the certifications required by the proposed regulation would be minimal.

Proposed Regulation AC, if adopted, would require that brokers and dealers establish and follow sufficient procedures to comply with the provisions of the proposed regulation and would require that the broker or dealer is able to: collect, process, and disclose the information required to be included in research reports; ensure the submission of information required to be submitted to the firm's compliance department; and periodically review and evaluate these procedures. Brokers or dealers should already have these procedures in place to meet existing obligations under the SRO rules relating

<sup>19</sup> Based on data provided by First Call, the staff of the Commission estimates that approximately 657,000 research reports were published in 2001.

<sup>20</sup> 519 is approximately 10% of the estimated 5,186 research analysts employed in the U.S., which is based on information provided by Nelson Information.

<sup>21</sup> OMB Control No. 3235-0279.

<sup>17</sup> 44 U.S.C. 3501 *et seq.*

<sup>18</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

to research analysts that recently were approved by the Commission.<sup>22</sup> Therefore, the Commission estimates that the proposed regulation would result in a total annual time burden of approximately 11,296 hours [10,950 hours to comply with research report requirements + 346 hours to comply with public appearance requirements], and a total annual cost in dollars of approximately \$1,372,464 [\$1,330,425 to comply with the research report requirements + \$42,039 to comply with the public appearance requirements].

### C. Request for Comment

The Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. We also request comment on how many public appearance certifications would likely be submitted to brokerage firms per quarter, and how many of those statements would be required to be provided to the firm's examining authority.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609, with reference to File No. S7-30-02. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-30-02, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication. Consequently, a comment to OMB is best assured of having its full effect if

OMB receives it within 30 days of publication.

### V. Costs and Benefits of the Proposed Rule

The Commission is considering the costs and the benefits of proposed Regulation AC. The Commission encourages commenters to discuss any costs or benefits in addition to those discussed below. In particular, the Commission requests comment on any potential costs, as well as any potential benefits, resulting from the proposals for investors, issuers, broker-dealers, other securities industry professionals, SROs, or others. Commenters should provide analysis and data to support their views on the costs and benefits associated with the proposed amendments.

#### A. Benefits

We believe that investor confidence in the integrity of research has suffered because some investors may believe that research analyst objectivity has been compromised due to, among other things, analysts' personal compensation and firms' investment banking relationships with issuers that are the subjects of research reports. Requiring that research analysts certify that the views expressed in research reports reflect their personal views, and requiring disclosure of information regarding whether analyst compensation is related to the specific recommendations made, would help bolster investor confidence in the quality of research. This, in turn, should help bolster investor confidence in the securities markets.

Proposed Regulation AC would require that broker-dealers include certifications in research reports regarding the accuracy of the views expressed in the research report. Firms would be required to include in their research reports certifications that the views expressed in the research report accurately reflect the analyst's personal views regarding the subject securities or issuers and whether or not the analyst received compensation in connection with the reports. Many investors rely on the research reports and recommendations provided by their brokers. To the extent that the proposed regulations require disclosures that provide more transparency than provided by current regulation, these disclosures should provide investors with important information with which to determine the value of the research available to them.

Proposed Regulation AC may result in an increase in the overall quality of the research available to the public because a broker-dealer would be in violation of

the securities laws when issuing research reports unless the reports include the required certifications and disclosures. The proposed requirement that the research analyst principally responsible for preparing the research report personally certify that the views expressed in the report accurately reflect his or her personal views creates an incentive for analysts to examine, even more carefully, the basis and foundations for his or her recommendations in preparing research reports.

Proposed Regulation AC may also result in an increase in the quality of research because of competitive reasons. Firms that publish research reports that do not contain certain analyst certifications will be in violation of the proposed regulation, and firms whose research analysts' compensation is related to the specific recommendations or views provided in research reports may lose some business to firms that are less conflicted. The proposed regulation is intended to enhance investor confidence in the integrity of the research available to them. We believe that by requiring research analysts to certify as to the accuracy of the views expressed in research reports, investor confidence in the securities markets should be enhanced, thereby leading to the benefit of more liquid and efficient markets. These benefits are difficult to quantify.

#### B. Costs

While the proposed regulation may lead to some additional costs for brokers or dealers, we believe that any costs should not be significant. The proposed certification and disclosure requirements would require research analysts to even more carefully consider the accuracy of the views expressed in research reports and public appearances, to consider their compensation arrangements, and then to make the required certifications and disclosures. In light of current requirements under SRO rules, the Commission estimates that, beyond the paperwork costs described above, any additional costs that would result from the required certifications and disclosures would be minimal.

Moreover, with respect to the compensation certifications and disclosures that would be required by proposed Regulation AC, brokers and dealers are already required to make certain disclosures regarding research analyst compensation under SRO rules.<sup>23</sup> Additionally, Exchange Act Rule 17a-3(a)(19) currently requires

<sup>22</sup> *Supra* note 10.

<sup>23</sup> See NASD Rule 2711 and NYSE Rule 472.

brokers or dealers to maintain a record of all agreements pertaining to the relationship between each associated person and the broker-dealer, including a summary of each associated person's compensation arrangement or plan.<sup>24</sup> Brokers or dealers should also already have in place procedures necessary to comply with many components of the proposed regulation due to existing obligations under SRO rules, although these procedures might require some minor modifications to conform with proposed Regulation AC. As noted previously, the Commission estimates that the annual paperwork costs in dollars of complying with the proposed regulation would be approximately \$1,372,464.

### C. Request for Comments

As an aid in evaluating costs associated with proposed Regulation AC, the Commission requests the public's views and any supporting information. We request comment on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of, or suggested alternatives to, the proposed regulation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

## VI. Regulatory Flexibility Act Certification

The Commission certifies, pursuant to 5 U.S.C. 605(b), that the proposed regulation would not, if adopted, have a significant economic impact on a substantial number of small entities. The purpose of the proposed regulation is to increase analyst independence; further manage conflicts of interest; require increased disclosures to investors; and promote investor confidence in the integrity of research. By improving the quality of disclosure, the proposed regulation should enhance investor confidence in the fairness and integrity of the securities markets. The requirements of the proposed regulation are closely related to information, procedures, and disclosures required by existing SRO rules, which apply to both large and small broker-dealers that publish or circulate research reports.

The Division of Market Regulation estimates that the total burden in hours required to comply with proposed Regulation AC would, at most, be approximately two hours and two

minutes per small firm. Accordingly, the Commission certifies that proposed regulation should not have a significant impact on a substantial number of small entities.

## VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"<sup>25</sup> we must advise OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

Where a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed regulation on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

## VIII. Effects on Competition, Efficiency and Capital Formation

Section 3(f) of the Exchange Act<sup>26</sup> requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. In addition, section 23(a)(2)<sup>27</sup> of the Exchange Act requires the Commission to consider the impact any rule would have on competition. Further, the law requires that the Commission not adopt any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed regulation is intended to enhance investor confidence in the integrity of the research available to them. We believe that requiring broker-dealers to include analyst certifications in research reports, as well as the other disclosures required by proposed Regulation AC, should enhance investor confidence in the securities markets, thereby leading to a more efficient

market. The Commission has considered the proposed regulation in light of the standards cited in section 23(a)(2) and believes preliminarily that it, if adopted, would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We request comment on whether the proposed amendments, if adopted, would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. We also request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Specifically, research analysts are employed by different kinds of entities. Therefore, we seek comment on whether the regulation should be more expansive. For example, should the proposed regulation cover banks that are not associated persons? Commenters are requested to provide empirical data and other factual support for their views if possible.

## IX. Statutory Authority

Regulation AC is being proposed pursuant to sections 3, 15, 17, and 23 of the Exchange Act and pursuant to sections 17 and 19 of the Securities Act.

## Text of the Proposed Regulation

### List of Subjects in 17 CFR Part 242

Securities.

In accordance with the foregoing, Title 17, Chapter II, of the Code of Federal Regulations is proposed to be amended as follows:

## PART 242—REGULATIONS M, ATS and AC

1. The authority citation for part 242 is revised to read as follows:

**Authority:** 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78mm, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 80a-23, 80a-29, and 80a-37.

2. The part heading for part 242 is revised as set forth above.

3. Part 242 is amended by adding Regulation AC, §§ 242.500 through 242.502 to read as follows:

### Regulation AC—Analyst Certification

Sec.

242.500 Definitions.

242.501 Research reports.

242.502 Public appearances.

### Regulation AC—Analyst Certification

#### § 242.500 Definitions.

For purposes of Regulation AC (§§ 242.500 through 242.502):

<sup>24</sup> These subparagraphs of the rule may be redesignated as Rule 17a-3(a)(12)(ii) and Rule 17a-3(a)(12)(iii), should the Commission adopt amendments proposed in October 2001. See Securities Exchange Act Release No. 44992 (October 26, 2001).

<sup>25</sup> Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. Section 601).

<sup>26</sup> 15 U.S.C. Section 78c(f).

<sup>27</sup> 15 U.S.C. Section 78w(a)(2).

*Public appearance* means 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 specific recommendation or offers an opinion concerning a security or an issuer.

*Research analyst* means any natural person who is principally responsible for the analysis of any security or issuer included in a research report.

*Research report* means a written communication that includes an analysis of the securities of an issuer or issuers, provides information reasonably sufficient upon which to base an investment decision and includes a recommendation.

#### **§ 242.501 Research reports.**

A broker or dealer, or any person associated with a broker or dealer, that publishes, circulates, or provides, directly or indirectly, a research report prepared by a research analyst shall include in that research report a clear and prominent certification by the research analyst containing the following statements:

(a) A statement attesting that the views expressed in the research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers; and

(b)(1) A statement attesting that no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analyst in the research report; or

(2) A statement:

(i) Attesting that part or all of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analyst in the research report;

(ii) Identifying the source and amount of such compensation and the purpose therefor; and

(iii) Further disclosing that the compensation could influence the recommendations or views expressed in the research report.

#### **§ 242.502 Public appearances.**

(a) If a broker or dealer, or any person associated with a broker or dealer, publishes, circulates, or provides, directly or indirectly, a research report prepared by a research analyst, the broker or dealer must make a record within thirty days after each calendar quarter in which the research analyst has made a public appearance that includes a certification by the research

analyst containing the following statements:

(1) A statement:

(i) Attesting that the views expressed by the research analyst in each public appearance accurately reflected the research analyst's personal views at that time about any and all of the subject securities or issuers; and

(ii) Attesting that no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analyst in any public appearance; or

(2) A statement attesting that the research analyst is unable to provide the written certifications specified in paragraph (a)(1) of this section and the reasons therefor. The broker or dealer must also disclose in all research reports prepared by the research analyst for the next 120 days that the research analyst did not provide the certifications specified in paragraph (a)(1) of this section and the reasons therefor.

(b) A broker or dealer shall promptly provide copies of all statements prepared pursuant to paragraph (a)(2) of this section to its examining authority, designated pursuant to Section 17(d) of the Securities Exchange Act of 1934 (15 USC 78q(d)) and § 240.17d-2 of this chapter.

(c) A broker or dealer shall preserve the records specified in paragraph (a) of this section in accordance with § 240.17a-4(b)(4) of this chapter.

By the Commission.

Dated: August 2, 2002.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-20031 Filed 8-7-02; 8:45 am]

**BILLING CODE 8010-01-P**

## **DEPARTMENT OF ENERGY**

### **Federal Energy Regulatory Commission**

#### **18 CFR Part 2**

**[Docket No. PL02-7-000]**

#### **Standard of Review for Proposed Changes to Market-Based Rate Contracts for Wholesale Sales of Electric Energy by Public Utilities**

August 1, 2002.

**AGENCY:** Federal Energy Regulatory Commission, DOE.

**ACTION:** Notice of proposed policy statement.

**SUMMARY:** The Federal Energy Regulatory Commission (Commission) is proposing to adopt a policy statement to

announce a general policy regarding the standard of review that must be met to justify proposed changes to market-based rate contracts for wholesale sales of electric energy by public utilities. The intent of the proposed policy statement is to promote the sanctity of contracts, recognize the importance of providing certainty and stability in competitive electric energy markets, and provide adequate protection of electric energy customers. The Commission is inviting comments on the proposed policy statement.

**DATES:** Comments on the proposed policy statement are due September 23, 2002.

**ADDRESSES:** File written comments with the Office of Secretary, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426.

#### **FOR FURTHER INFORMATION CONTACT:**

Shaheda Sultan, Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426, Telephone: (202) 219-2685.

Jonathan First, Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426, Telephone: (202) 208-2142.

*Before Commissioners:* Pat Wood III, Chairman; William L. Massey, Linda Breathitt, and Nora Mead Brownell.

### **Proposed Policy Statement**

#### **I. Introduction**

1. The Federal Energy Regulatory Commission is proposing to adopt a policy statement to announce a general policy regarding the standard of review that must be met to justify proposed changes to market-based rate contracts for wholesale sales of electric energy by public utilities. The specific prices, terms and conditions of service agreed to by willing sellers and buyers in such contracts are not required to be filed with the Commission when these contracts are entered into pursuant to generic market-based rate tariffs already approved by, and on file with, the Commission.<sup>1</sup> Because the generic tariffs are authorized only after the Commission has made findings that the sellers under such tariffs lack or have mitigated market power, the prices, terms and conditions of contracts pursuant to market-based tariffs are presumed to fall within a zone of

<sup>1</sup> See Order No. 2001, Revised Public Utility Filing Requirements, III FERC Stats. & Regs., Regulations Preambles ¶ 31,127 at 30,135-140 (April 25, 2002), *reh'g pending* (although contracts are not filed, detailed information about each transaction is reported to the Commission).