U.S. Securities and Exchange Commission

Commission Approves Rules to Address Analyst Conflicts SEC Also Requires EDGAR Filings by Foreign Issuers

FOR IMMEDIATE RELEASE
2002-63

Washington, D.C., May 8, 2002 — The Commission today approved proposed changes to the rules of the National Association of Securities Dealers and the New York Stock Exchange to address conflicts of interest that are raised when research analysts recommend securities in public communications. These conflicts can arise when analysts work for firms that have investment banking relationships with the issuers of the recommended securities, or when the analyst or firm owns securities of the recommended issuer.

These rules include the following provisions, among others:

- **Promises of Favorable Research.** The rules changes will prohibit analysts from offering or threatening to withhold a favorable research rating or specific price target to induce investment banking business from companies. The rule changes also impose "quiet periods" that bar a firm that is acting as manager or co-manager of a securities offering from issuing a report on a company within 40 days after an initial public offering or within 10 days after a secondary offering for an inactively traded company. *Promising favorable research coverage to a company will not be as attractive if the research follows research issued by other analysts.*

- **Limitations on Relationships and Communications.** The rule changes will prohibit research analysts from being supervised by the investment banking department. In addition, investment banking personnel will be prohibited from discussing research reports with analysts prior to distribution, unless staff from the firm's legal/ compliance department monitor those communications. Analysts will also be prohibited from sharing draft research reports with the target companies, other than to check facts after approval from the firm's legal/compliance department. *This provision helps protect research analysts from influences that could impair their objectivity and independence.*

- **Analyst Compensation.** The rule changes will bar securities firms from tying an analyst's compensation to specific investment banking transactions. Furthermore, if an analyst's compensation is based on the firm's general investment banking revenues, that fact will have to be

disclosed in the firm's research reports. *Prohibiting compensation from specific investment banking transactions significantly curtails a potentially major influence on research analysts' objectivity.*

- **Firm Compensation.** The rule changes will require a securities firm to disclose in a research report if it managed or co-managed a public offering of equity securities for the company or if it received any compensation for investment banking services from the company in the past 12 months. A firm will also be required to disclose if it expects to receive or intends to seek compensation for investment banking services from the company during the next 3 months. *Requiring securities firms to disclose compensation from investment banking clients can alert investors to potential biases in their recommendations.*

- **Restrictions on Personal Trading by Analysts.** The rule changes will bar analysts and members of their households from investing in a company's securities prior to its initial public offering if the company is in the business sector that the analyst covers. In addition, the rule changes will require "blackout periods" that prohibit analysts from trading securities of the companies they follow for 30 days before and 5 days after they issue a research report about the company. Analysts will also be prohibited from trading against their most recent recommendations. *Removing analysts' incentives to trade around the time they issue research reports should reduce conflicts arising from personal financial interests.*

- **Disclosures of Financial Interests in Covered Companies**. The rule changes would require analysts to disclose if they own shares of recommended companies. Firms will also be required to disclose if they own 1% or more of a company's equity securities as of the previous month end. *Requiring analysts and securities firms to disclose financial interests can alert investors to potential biases in their recommendations.*

- **Disclosures in Research Reports Regarding the Firm's Ratings.** The rule changes will require firms to clearly explain in research reports the meaning of all ratings terms they use, and this terminology must be consistent with its plain meaning. Additionally, firms will have to provide the percentage of all the ratings that they have assigned to buy / hold / sell categories and the percentage of investment banking clients in each category. Firms will also be required to provide a graph or chart that plots the historical price movements of the security and indicates those points at which the firm initiated and changed ratings and price targets for the company. *These disclosures will assist investors in deciding what value to place on a securities firm's ratings and provide them with better information to assess its research.*

- **Disclosures During Public Appearances by Analysts.** The rule changes will require disclosures from analysts during public appearances, such as television or radio interviews. Guest analysts will have disclose if they or their firm have a position in the stock and also if the company is an investment banking client of the firm. *This*

disclosure will inform investors who learn of analyst opinions and ratings through the media, rather than in written research reports, of analyst conflicts.

The Commission will request the NASD and NYSE to report within a year of implementing these rules on their operation and effectiveness, and whether they recommend any changes or additions to the rules.

These rules are part of an ongoing process by the Commission, NASD, NYSE, and the states to address conflicts of interest affecting the production and dissemination of research by securities firms. On April 24, 2002, the Commission announced that it had commenced a formal inquiry into market practices concerning research analysts and the conflicts that can arise from the relationship between research and investment banking. It is possible that this inquiry will indicate the need for further rulemaking by the NASD and NYSE or additional Commission action.

Provisions of these rule changes will take effect 60 to 180 days from issuance of the Commission's order, depending on the provision.

Adoption of Mandated EDGAR Filing for Foreign Issuers

The Commission also today adopted rule amendments that will require foreign companies and foreign governments to file their Securities Act and Exchange Act documents electronically through the Commission's Electronic Data Gathering, Analysis and Retrieval (EDGAR) System. Currently the Commission's rules only permit, but do not require, foreign issuers to file their securities documents on EDGAR. By mandating the electronic filing of foreign issuers' securities documents on EDGAR, the Commission seeks to realize the same investor benefits and the same efficiencies in information transmission, dissemination, retrieval and analysis that it has achieved through mandated EDGAR filing for domestic issuers.

The Commission adopted electronic filing requirements for domestic companies in 1993 and completed the phase-in of these requirements in 1996. Since its inception, the primary goal of the EDGAR system has been to facilitate the more rapid dissemination of, and easier access to, financial and business information about companies and other parties participating in U.S. capital markets.

Since the Commission's adoption of EDGAR filing requirements for domestic issuers, numerous advances in information and telecommunications technology have occurred that have transformed the Internet into a principal means for the rapid dissemination and retrieval of information. These technological advances, together with the Commission's modernization of EDGAR, should reduce the costs of EDGAR filing for foreign issuers and make these costs more comparable to those of domestic filers. Because of these advances, the Commission believes that the investing public has come to expect to be able to access electronically information about public companies, regardless of their country of origin, and about foreign governments.

The final rules will amend Regulation S-T, the Commission's rules governing electronic filing, to eliminate the foreign issuer exception from mandated EDGAR filing for most Securities Act and Exchange Act documents. The amendments will require the electronic filing of:

- foreign private issuers' Securities Act registration statements and Exchange Act registration statements and reports;
- foreign governments' Securities Act registration statements and Exchange Act registration statements and reports;
- Multijurisdictional Disclosure System (MJDS) forms filed by Canadian issuers;
- Statements of beneficial ownership on Schedules 13D and 13G and tender offer schedules that pertain to the securities of a foreign issuer, whether filed by a foreign or domestic person;
- Form CB, the form used for cross-border rights offers, exchange offers and business combinations that are exempt from the tender offer rules or Securities Act registration, if the filer is an Exchange Act reporting company;
- Form 6-K reports, except under specified circumstances, when paper filing would be permitted; and
- most Trust Indenture Act forms.

The amendments will further

- permit, but not require, supranational entities, such as the World Bank, to file their reports electronically;
- continue to require documents submitted under Exchange Act Rule 12g3-2(b)[1] to be in paper only;
- eliminate the requirement that a first-time EDGAR filer provide a paper copy of its electronic filing to the Commission; and
- permit a national securities exchange to file a Form 25, which reports the delisting of a company's class of securities, voluntarily on EDGAR.

A majority of commenters generally supported the proposed EDGAR filing requirements for foreign issuers discussed in Release No. 33-8016 (September 28, 2001). The final rules will include several changes from the proposal to accommodate commenters' concerns. The following are some of the principal changes.

- The Commission proposed to eliminate the option of providing an

English summary instead of a full English translation of a foreign language exhibit or attachment to a filing. The final rules will permit the use of an English summary, with exceptions codified for specified, significant documents. The final rules also provide better guidance than the current rules regarding what constitutes an adequate summary.

- The Commission proposed to require the EDGAR filing of all Form 6-K reports except in one instance—when submitting a foreign company's attached "glossy" annual report to security holders. The final rules will provide for another exception. If the content of a Form 6-K report has not been distributed to the press or the company's security holders, and does not contain new material information, the issuer may submit the Form 6-K report in either paper or electronic format.

- The Commission proposed to retain the current requirement that electronic filings include a written representation regarding the fairness and accuracy of any English translation. The final rules will eliminate this written representation requirement.

- Finally, rather than adopting a four month transition period, as proposed, the final rules will go into effect November 4, 2002—almost six months from today. This transition period will give filers adequate preparation time. The release encourages companies to submit test filings or to begin electronic filing on a voluntary basis during this transition period.

Extension of Exemption from Definitions of "Broker" and "Dealer"

Finally, the Commission approved the issuance of an order extending the temporary exemption of banks, savings associations and savings banks from the definitions of "dealer" until Nov. 12, 2002, and "broker" until May 12, 2003, under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934.

Endnotes

[1] This rule provides an exemption from Section 12(g) of the Exchange Act for foreign private issuers that have not chosen to access the U.S. capital markets. One condition to obtaining the exemption is that an applicant must furnish to the Commission on an ongoing basis its securities documents required to be furnished or that it furnishes voluntarily in its home country.

http://www.sec.gov/news/press/2002-63.htm