

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56481; File No. SR-FINRA-2007-010)

September 20, 2007

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change 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.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 12, 2007, Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing 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.

The text of the proposed rule change is available at FINRA, on FINRA's Web site at <http://www.finra.org>, and in the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.³

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

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. In the context of this requirement, the Rules define “research analyst” 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.” The term “research report” in the Rules have the meaning as defined in NASD Rule 2711(a)(8) and NYSE Rule 472.10(2): a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.

Pursuant to the Rules, FINRA has implemented the Research Analyst Qualification Examination (Series 86/87). The examination consists of an analysis part (Series 86) and a regulatory part (Series 87). Prior to taking either the Series 86 or 87, a candidate also must have passed the General Securities Registered Representative Examination (Series 7), the Limited Registered Representative (Series 17), or the Canada Module of Series 7 (Series 37 or 38). Persons who were functioning as research analysts

³ The Commission has modified part of these statements.

on the effective date of March 30, 2004, and submitted a registration application to NASD by June 1, 2004, had until April 4, 2005, to meet the registration requirements. The Rules currently provide exemptions from the Series 86 examination for certain applicants who have passed Levels I and II of the Chartered Financial Analyst examination or have passed Levels I and II of the Chartered Market Technician Examination and produce only “technical research reports” as that term is defined in the Rules. The Rules further exempt 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 latter exemption.

Current Exemption

In March 2004, FINRA and the New York Stock Exchange issued joint guidance on the determination of whether a research report is considered the product of a member or that of a third party, including a foreign affiliate.⁴ The guidance explained that FINRA considers 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. Where either of the two factors pertain, the research report and any “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. Thus, for example, a “globally-branded” research report that is not clearly labeled to the reader as being wholly the product of a foreign affiliate would be deemed the member’s research. Similarly, FINRA considers a research report

⁴ See NASD Notice to Members 04-18 and New York Stock Exchange 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.

prepared by a “mixed-team” that includes at least one research analyst associated with the member to be a member’s report for the purpose of application of NASD Rule 2711 and NYSE Rule 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. FINRA affirmed this interpretation in announcing the Research Analyst Qualification Examination in a March 2004 Notice to Members 04-25.

Subsequently, some members requested an exemption from the Rules for certain research analysts associated with a member who reside in certain foreign jurisdictions. FINRA was concerned that absent the safe harbor for certain foreign analysts, members might have had a pragmatic incentive, although not a defensible basis, for construing associated person status on an unduly narrow basis. To alleviate these issues, while maintaining – and in some cases, extending – the safeguards in FINRA rules that ensure objective and quality research, 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 New York Stock Exchange, and subject to certain conditions.

The Commission approved the proposed exemption in May 2005.⁵ FINRA recognized as the basis for exemptive relief from the registration and qualification

⁵ 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).

requirements compliance with other standards in foreign jurisdictions that reflect recognition of principles that are consonant with FINRA qualification standards and the research analyst conflict of interest rules. These principles generally include a combination of (1) rules that govern research analysts and firm conflicts of interest in the preparation and distribution of research reports; (2) a requirement that research analysts be registered or licensed by a regulatory authority; or (3) a testing or experience requirement that demonstrates research analysts' skills and/or knowledge of rules and regulations applicable to research analysts and their firms in the preparation and distribution of research reports. 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. FINRA and the New York Stock Exchange approved seven jurisdictions that met the applicable standard: the United Kingdom, Thailand, China, Hong Kong, Singapore, Malaysia and Japan.⁶

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

⁶ See NASD Notice to Members 05-24 and New York Stock Exchange Information Memo 05-23.

is not globally-branded.⁷ Eligibility for the exemption would further be conditioned on the member meeting certain supervisory, disclosure and recordkeeping requirements.

Supervisory Review

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.⁸ In addition, the member would be required to ensure that such research reports comply with NASD Rule 2711 and NYSE Rule 472, as applicable.

Disclosure

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 front page of each such 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 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

⁷ When used in reference to NYSE Rule 344.10, the term “member” refers to both a natural person and “member organization.”

⁸ See NASD Notice to Members 04-81 and 07-04.

restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

Recordkeeping

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.

FINRA views the proposed rule change as an iteration of the existing exemption that will better encourage dissemination to investors of globally-branded and foreign research where determination of FINRA's jurisdiction can be doubtful. At the same time, FINRA believes the proposal balances investor protection concerns by ensuring that all research produced by foreign research analysts who avail themselves of the exemption are subject to supervision, disclosure and other beneficial safeguards, even where the foreign research analyst may not be an associated person of the member and therefore not subject to FINRA regulatory oversight.

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.

The filing includes a statement about when FINRA will announce the effective date of the proposed rule change.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A of the Act, including Section 15A(b)(6) of the Act,⁹ in that it is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and, in general, to protect investors and the public interest. 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.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden

⁹ 15 U.S.C. 78o-3(b)(6).

on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. **Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments were neither solicited nor received.

III. **Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. **Solicitation of Comments**

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

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Florence E. Harmon

Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).