



Final Rule: Regulation AC

The Securities and Exchange Commission (“SEC”) has adopted new Regulation Analyst Certification (“Regulation AC”). Regulation AC becomes effective as of April 14, 2003.

I. Final Rule: Regulation AC

Research Reports & Certifications

Regulation AC requires broker-dealers and their associated persons¹ that are “covered persons”² that publish³ or provide research reports to include in those research reports:

- A statement by the research analyst(s) certifying that the views expressed in the report accurately reflect such research analyst’s personal views; and
- A statement by the research analyst (or analysts) certifying either (i) that no part of his or her compensation was or will be directly or indirectly related to the recommendations or views in the research report or (ii) that his or her compensation was or will be directly or indirectly related to the recommendations or views in the research report.⁴

A broker-dealer or covered person that publishes or provides research reports prepared by a “third-party research analyst”⁵ is exempt from the provision

¹ Section 3(a)(18) of the Securities Exchange Act of 1934 defines “person associated with a broker or dealer” or “associated person of a broker or dealer” as “. . . any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by or under common control with such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of this title.”

² The addition of the term “covered persons” limits the rule’s scope. See discussion of “covered persons” in Section II below.

³ “Publish” is defined in Regulation AC to mean dissemination by any means, including through any third party.

⁴ If the analyst’s compensation was, is, or will be directly or indirectly related to the recommendations or views in the research report, the statement must include the source, amount, and purpose of such compensation, and further disclose that it may influence the recommendation in the research report.

⁵ The addition of the term “third party research analyst” limits the rule’s scope. See discussion of “third party research analyst” in Section II below.

above provided (i) the employer of the third party research analyst has no officers or employees in common with the broker-dealer or covered person and (ii) the broker-dealer (or broker-dealer with which the covered person is associated) maintains and enforces written policies and procedures reasonably designed to prevent the broker-dealer or any of its controlling persons or employees from influencing the activities of a third party research analyst and the content of his or her research reports.⁶

Public Appearances

Broker-dealers must keep records related to public appearances by research analysts.⁷ Specifically, if a broker-dealer publishes or provides a research report prepared by a research analyst employed by the broker-dealer or a covered person, the broker-dealer is required to make a record within thirty days after each calendar quarter in which the research analyst made any public appearance that includes:

- A statement by the research analyst that the views expressed in all public appearances during the calendar quarter accurately reflected the research analyst’s personal views at that time; and
- A statement by the research analyst certifying that no part of such research analyst’s compensation was or will be directly or indirectly related to any recommendations or views expressed in any such public appearance.

If the broker-dealer does not obtain such a statement, the broker-dealer must notify its examining authority. In addition, for 120 days thereafter, the broker-dealer must disclose in any research report it distributes authored by that analyst that the analyst did not provide the required certification.

⁶ The SEC in its adopting release stated that Regulation AC will not apply to broker-dealers that distribute research prepared by a third party research analyst whose employer satisfies certain independence criteria.

⁷ This provision is notably different from the version of Regulation AC that was proposed by the SEC in 2002 as it does not require research analysts to make certifications during public appearances.

II. Differences from Proposed Regulation AC

Regulation AC, as adopted, differs from “proposed Regulation AC”⁸ in the following respects:

Scope of Regulation AC

- The SEC has added the definition of “covered person” to narrow the scope of persons to which Regulation AC applies. Covered person means a person associated with a broker-dealer, but not including an associated person that has no officers or employees in common with the broker-dealer, and where the broker-dealer maintains and enforces written policies and procedures reasonably designed to prevent the broker-dealer or any of its controlling persons, officers, or employees from influencing the activities of research analysts and the content of research reports. It is the SEC’s belief that it is unnecessary to apply Regulation AC to research published, circulated, or provided by associated persons who have a sufficient level of independence from the broker-dealer with which they are associated.
- To provide certainty, a broker-dealer must now notify its associated persons that issue research reports as to whether the broker-dealer maintains and enforces such written policies and procedures and whether the associated persons have any officers or employees in common with the broker-dealer and identify such persons.
- Investment advisers prohibited under Section 203A of the Investment Advisers Act of 1940 (in effect, state registered advisers) from registering with the SEC as investment advisers and that are not required to be registered as broker-dealers are excluded from the rule.
- The definition of “third party research analyst” has been added. A “third party research analyst” is, with respect to a particular broker-dealer, any research analyst not employed by that broker-dealer or any associated person of that broker-dealer. With respect to a covered person, a “third party research analyst” is any research analyst not employed by that covered person, by the broker-dealer with whom that covered person is associated, or by any other associated person of the broker-dealer with whom that covered person is associated. It is the SEC’s belief that research prepared by a third party research analyst will not be suscep-

tible to pressures from broker-dealers who distribute their research provided that the analyst’s employer meets certain independence criteria.

Research Reports & Public Appearances

- The definition of “research report” now explicitly includes written communications in electronic form.
- The “recommendation” element from the definition of “research report” has been removed. “Research report” is now defined as a written communication including an analysis of a security or an issuer and provides information upon which to base an investment decision.
- Only the analyst(s) primarily responsible for the preparation of the content of a research report must comply with the certification requirements. Thus, certification by junior analysts involved in the preparation of a research report is not necessary.
- When an analyst is not identifiable because the report is based on the firm’s quantitative or technical model, the firm itself may provide the certifications.
- Research analyst certifications during public appearances are not required. The SEC believes that the proposed quarterly certification requirements in connection with analyst public appearances are sufficient.
- Regulation AC is directed to broker-dealers and covered persons because the SEC believes that these entities are subject to the greatest conflicts. Therefore, the research report certification provisions of Regulation AC apply to investment advisers and banks, among others, that are covered persons and publish or provide research reports.
- Regulation AC will not apply to a broker-dealer that distributes research prepared by a third party research analyst whose employer satisfies certain independence criteria. The independence criteria require (i) that the third party research analyst’s employer does not have officers or employees in common with the broker-dealer or covered person distributing its research and (ii) that the broker-dealer has written policies and procedures designed to prevent the broker-dealer, its controlling persons, officers, and employees from influencing the activities of the third party research analyst and the content of his or her research reports.
- A narrow exception has been created for foreign persons that are located outside of the U.S. and are not associated with a registered broker-dealer

⁸ We refer you to our Client Publication “Proposed Regulation AC” circulated in August 2002.

that prepares and provides research on foreign securities to major U.S. institutions in the U.S. pursuant to Rule 15a-6(a)(2) promulgated under the Securities Exchange Act of 1934.

- In the case of a research analyst employed outside the U.S. by a foreign person located outside the U.S., Rule 502 of Regulation AC only applies to public appearances while the research analyst is physically present in the U.S.
- When a research report covers more than one company and each research analyst required to certify with respect to the views expressed in a portion of the report is able to certify that (i) the views expressed in the research report accurately reflect such research analyst's personal views about the subject securities and companies and (ii) that no part 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, the firm may comply with Regulation AC by including one clear and prominent combined certification that, as to each company covered, the respective research analyst (or analysts) certifies as to (i) and (ii) above.

It should be noted that Regulation AC continues to apply to debt securities as well as equity securities. The SEC has determined that applying Regulation AC to debt securities as well as equity securities would benefit investors because it would provide to debt investors the same benefits as equity investors by promoting the integrity of research reports and confidence in research analyst recommendations.

A copy of Regulation AC and the release discussing its adoption by the SEC can be found at the SEC's website located at <http://www.sec.gov>.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. For more information on the topics covered in this issue, please contact:

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