

Foreign Research Disclosures and Related Issues Under Rule 15a-6, Regulation AC and FINRA Rules

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The following is a summary of the disclosure requirements that apply to research of a foreign broker-dealer (“Foreign Research”) distributed to investors in the United States in accordance with Rule 15a-6 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”),¹ Regulation Analyst Certification (“Regulation AC”) under the Exchange Act, and applicable rules of the Financial Industry Regulatory Authority (“FINRA”), as well as related research analyst licensing, supervisory and recordkeeping requirements.

A model research disclosure template for Foreign Research is available [here](#).

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I. Mandatory Disclosures

Regulation AC Disclosure and Certifications

Regulation AC applies to any foreign broker-dealer associated with a U.S. registered broker-dealer that provides Foreign Research to persons in the United States. Specifically, Regulation AC requires that the research include:

- A. 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; and
- B. a statement by the research analyst certifying either:

¹ Rule 15a-6 was adopted by the SEC in 1989 to clarify the circumstances in which a foreign broker-dealer may interact with U.S. investors without having to register with the SEC. The rule provides exemptions from broker-dealer registration for, among other things, the provision of research without more by a foreign broker-dealer to major U.S. institutional investors in accordance with Rule 15a-6(a)(2), and broader contacts with U.S. institutional investors and major U.S. institutional investors through a U.S. registered broker-dealer intermediary under Rule 15a-6(a)(3). The following assumes that the Foreign Research is being distributed to U.S. investors and foreign analysts or sales persons are initiating follow-up contacts with those U.S. investors under Rule 15a-6(a)(3).

1. that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report; or
2. that part or all of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained 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.

Rule 15a-6 Trade Execution Disclosure

Under Rule 15a-6(a)(3), any transactions conducted by a foreign broker-dealer with U.S. persons in the securities described in Foreign Research must be effected through a U.S.-registered broker-dealer. Accordingly, all Foreign Research distributed to U.S. persons should include a statement advising U.S. investors that any resulting transactions should be effected through a U.S.-registered broker-dealer identified for that purpose. Moreover, if the Foreign Research may be distributed to persons who are *not* major U.S. institutional investors, then the U.S. broker-dealer must accept responsibility for the contents of the Foreign Research and a disclosure to that effect should be included in the research report. This is recommended, as well, to the extent that any Foreign Research is distributed to major U.S. institutional investors in states where there is no institutional exemption from registration in the state comparable to the definition of major U.S. institutional investor in Rule 15a-6.

FINRA Rule 2711 Analyst Conflict Disclosures

FINRA Rule 2711 requires that a member broker-dealer disclose in third-party research reports distributed by it, including Foreign Research, certain conflicts of interest pertaining to ownership of the subject securities, investment banking and other business relationships with the issuer, compensation of research analysts, market-making and other activities. Specifically, the member broker-dealer must disclose in Foreign Research: (1) whether the member or its affiliates, including its parent and other affiliated entities, beneficially own 1% or more of the subject securities; (2) whether the member or an affiliate managed or co-managed a public offering of securities for the subject company in the past 12 months, received compensation for investment banking services from the subject company in the past 12 months, or expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months; (3) whether there are any other actual, material conflicts of interest of the member at the time of publication;² and (4) whether the member is a market maker in the subject company's securities.

In a typical chaperoning arrangement between a U.S. registered broker-dealer (that's a FINRA member) and its foreign affiliate, some of these disclosures will relate only to the U.S. broker-dealer, while others will relate to the U.S. broker-dealer, the foreign broker-dealer affiliate and any other affiliates of the U.S. broker-dealer.

II. Additional Recommended Disclosures

Certain disclosures required of member firms by FINRA Rule 2711 do not apply to non-member Foreign Research distributed by the member. These include (1) an explanation of the rating system employed by the firm; (2) a ratings distribution chart indicating the percentage of all securities rated by the firm to which the firm has assigned a "buy," "sell" or "hold" rating; (3) a description of the valuation method used by the firm to determine any price target contained in the report and a disclosure concerning the risks that might impede achievement of the price target; and (4) a price chart for securities for which the firm has assigned a rating or price target for at least one year that (a) indicates the dates on which the firm assigned or changed each rating or price target, and (b) depicts each rating and price target assigned or changed on those dates. While these

² Notice to Members 04-18 suggests that, among other things, receipt by the member or an affiliate of non-investment banking compensation from the issuer that represents an actual, material conflict of interest of the member known at the time of distribution of the research report would have to be disclosed under this provision.

requirements technically do not apply to Foreign Research, it may be prudent for foreign broker-dealers to consider making such disclosures in Foreign Research distributed in the United States through a U.S. broker-dealer and FINRA member firm or otherwise in accordance with Rule 15a-6(a)(2).

III. Globally Branded Research

More extensive disclosures are required for research reports distributed by a U.S. broker-dealer (that's a FINRA member) that are "globally branded" with a foreign broker-dealer. A "globally branded" research report is one that uses a single marketing identity encompassing both the U.S. broker-dealer and the foreign broker-dealer. Whether any brand or mark may be considered a global brand depends on the facts and circumstances, and turns on whether investors would be likely to associate the research with the U.S. broker-dealer as a result of the name, logo or other identifying information. In publishing or otherwise distributing a research report that is globally-branded with an affiliated or unaffiliated foreign broker-dealer, a U.S. broker-dealer should identify in the research report the foreign broker-dealer contributing to the report as well as the names of all foreign research analysts responsible for preparing the report. The research report also should disclose, as applicable, (1) that the foreign research analyst is not registered/qualified as a research analyst with FINRA, and (2) that the foreign research analyst may not be an associated person of the U.S. broker-dealer and as such would not be subject to Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.

All other disclosures required by Rule 2711 of member research must be included in Foreign Research that is globally branded with a U.S. registered broker-dealer (that's a FINRA member), including: (1) whether, as of the end of the month preceding the date of the research report (or the end of the second most recent month if the publication date is less than 30 days after the most recent month end), (a) the subject company was a client of the member within the past 12 months, and (b) the member received any compensation from the subject company for non-investment banking products or services within the past 12 months and the nature of such services as investment banking, non-investment banking or non-securities services; and (2) whether, during the past 12 months, the foreign broker-dealer (if affiliated) or any other affiliate of the U.S. broker-dealer received non-investment banking compensation from the subject company (although such disclosure would not be required if the U.S. broker-dealer employed policies and procedures to wall off employees with the ability to influence the substance of globally branded research reports from receiving information about such compensation).

FINRA takes the view that globally branded research could reasonably appear to an investor to be a product of the member (even if the substance of the report was, in fact, prepared by an affiliate or the subject securities are traded on an overseas market) and, as such, all of the Rule 2711 disclosures should be made to the research. Even if research is not globally branded, it may be prudent to make the disclosures regarding the identification of the entities and foreign research analysts responsible for preparing the research, as well as the disclaimers with respect to such research analysts' qualifications in the United States.

IV. Registration of Research Analysts

A research analyst employed by a foreign broker-dealer should not be required to qualify as a research analyst in the United States to the extent that he or she does not contribute to a U.S. broker-dealer's own research (other than globally-branded research as discussed above) or mixed-team research.

FINRA Rule 1050 sets out the registration and qualification requirements applicable to research analysts, including foreign research analysts associated with member firms. Section 1050(f) specifically excludes from the registration and examination requirements (Series 86/87) of the rule, "foreign research analysts"³ who

³ For purposes of Rule 1050, a foreign research analyst is a research analyst who is an employee of a non-member foreign affiliate of a member. Whether research analysts employed by a foreign broker-dealer affiliate of a member may be deemed foreign research analysts "associated with" the member depends upon whether there's a control relationship between the firms. Global branding of research may be sufficient to establish such a relationship.

reside outside the United States, and contribute, partially or entirely, to the preparation of Foreign Research or globally-branded research, provided that the foreign research analysts do not contribute to the preparation of the member's research, including a mixed-team report, that is not globally-branded.

The disclosures discussed above regarding the foreign research analyst's exemption from the licensing requirements of Rule 1050, as well as the restrictions on communications with the issuer, investment bankers and customers and prospective customers under Rule 2711, would be necessary to perfect the Rule 1050(f) exemption with regard to globally branded research.

V. Due Diligence and Supervision

All Foreign Research distributed by a U.S. broker-dealer and FINRA member firm should be approved by a qualified principal or supervisory analyst in accordance with FINRA Rules 2210 and 2711. FINRA Rule 2210 requires that all sales literature, including research reports, be approved by a supervisory principal (Series 24) prior to distribution by the member. FINRA Rule 2711(h)(13) requires that third party research be reviewed and approved by signature or initial of a general securities principal or supervisory analyst (Series 16) of the member to ensure that the content is consistent with applicable standards regarding communications with the public as required by Rule 2210(d)(1)(B).⁴ Rule 2210(d)(1)(B) provides that no member shall publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. FINRA Rule 2711(h)(13)(C) provides that a member's obligation to review third party research for untrue or misleading statements extends to information that should be known from reading the report or is known based upon information otherwise possessed by the member. In this regard, Notice to Members 07-04 makes clear that the member is not required to validate the preparing firm's methodologies, analysis or judgment. A similar pre-use review would be required in order for the distributing firm to accept responsibility for the content of the Foreign Research for purposes of Rule 15a-6.⁵

FINRA Rule 2711 requires that members adopt and implement written supervisory policies and procedures reasonably designed to ensure compliance with the pre-use review requirements of Rules 2210 and 2711(h)(13), and to ensure the completeness and accuracy of the disclosures contained in research reports.

VI. Recordkeeping

U.S.-registered broker-dealers and FINRA member firms distributing Foreign Research must make and preserve, in accordance with the recordkeeping requirements of Rule 17a-3 under the Exchange Act and FINRA Rule 3010, records evidencing compliance with the content, disclosure and supervisory requirements set out above. These records should be preserved for a period of not less than three years, the first two years in an easily accessible place.

In addition, U.S. broker-dealers should create and maintain records identifying foreign research analysts at their foreign affiliates who are relying on the exemption from registration afforded by Rule 1050(f), the basis for such exemption, and evidence of compliance with the conditions of the exemption.

⁴ To the extent that Foreign Research is reviewed by a supervisory analyst that is not a registered principal, the supervisory analyst should be subject to direct supervision by a registered principal.

⁵ A similar standard for review as FINRA Rule 2711 was articulated by the SEC for U.S. registered broker-dealers that accept responsibility for the content of research prepared by foreign broker-dealers. Footnote 116 of the Rule 15a-6 Adopting Release indicates that accepting responsibility for the research prepared by a foreign broker-dealer would occur where a registered broker-dealer "took reasonable steps to satisfy itself regarding the key statements in the research. In cases where there are no indications that the content of the research is suspect, this responsibility may be fulfilled by reviewing the research and comparing it with other public information readily available regarding the issuer, to make certain that neither the facts nor the analysis appear inconsistent with outstanding information regarding the issuer."

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Please contact us if you would like to discuss the above or related issues with us.

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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