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SEC ADOPTS REGULATION ANALYST CERTIFICATION

By Richard P. Wolfe and Amos J. Oelking III

On February 20, 2003, the SEC adopted Regulation Analyst Certification ("Regulation AC") which requires research analysts to make certain certifications in research reports and in connection with public appearances. Regulation AC became effective April 14, 2003. ([Click here to link to the full text of the SEC's release adopting Regulation AC.](#))

Research Reports

Regulation AC requires brokers, dealers and associated persons that are "covered persons" (discussed below) that publish or circulate research reports by analysts concerning public companies to include the following in such reports:

- a certification by the research analyst that the views expressed in the report "accurately reflect the research analyst's personal views" about the subject security and issuer; and
- a certification by the analyst as to whether any part of his compensation was, is or will be, directly or indirectly, related to his specific recommendation or views contained in the research report. If any part of the analyst's compensation was or will be so related, disclosure of the source, amount and purpose of the compensation is also required, as is a statement that such compensation may have influenced the analyst's recommendations and views expressed in the report.

The SEC expects these certifications (or a page reference thereto) to be included on the front page of the research report.

If the analyst is unable to certify that the report accurately reflects his personal views, distribution of the report by the broker-dealer or covered person would violate Regulation AC. Similarly, if the report does not contain one of the two alternative certifications regarding analyst compensation, distribution of the report by the broker-dealer or covered person would violate Regulation AC.

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Public Appearances

Regulation AC also requires broker-dealers to maintain records with respect to public appearances by research analysts. Regulation AC defines a “public appearance” as any participation in “a seminar, forum (including an interactive electronic forum), or radio or television or other interview, in which the research analyst makes a specific recommendation or provides information reasonably sufficient upon which to base an investment decision about a security or an issuer.”

A broker-dealer who publishes or circulates a research report prepared by a research analyst employed by the broker-dealer or a covered person is required to “make a record” within 30 days after each calendar quarter in which the analyst made a public appearance. This record must include:

- a written certification by the analyst that the views he expressed during all public appearances during the quarter accurately reflected the analyst’s personal views at that time about the subject security and issuer; and
- a written certification by the analyst that no part of his compensation was, is or will be, directly or indirectly, related to any specific recommendations or views expressed during any public appearance.

If the broker-dealer does not obtain such certifications from the analyst, the broker-dealer must “promptly” notify its examining authority of such fact. Moreover, for 120 days following such notification, the broker-dealer must disclose in any research report it distributes authored by the analyst that the latter did not provide the certifications, and maintain such records pursuant to Exchange Act Rule 17a-4 for at least 3 years.

Definition of “Covered Person”

In response to comments on its proposed Regulation AC, the SEC has included a definition of “covered person” in order to narrow the scope of persons to which Regulation AC applies. “Covered persons” are persons associated with a broker or dealer.

However, an associated person of a broker or dealer is not a covered person if (i) such person has no officers or employees in common with the broker or dealer who can influence the activities of analysts or the content of

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research reports, and (ii) the broker or dealer maintains and enforces written policies and procedures “reasonably designed” to prevent the broker or dealer or any controlling person, officer, or employee from influencing the activities of analysts and the content of research reports prepared by the associated person. Regulation AC requires a broker-dealer to notify associated persons that issue research reports whether it maintains and enforces such policies and procedures and whether the associated person has any officers or employees in common with the broker-dealer.

In addition, an associated person is not a covered person if such person is an investment adviser not registered or required to be registered with the SEC as either an investment adviser or a broker-dealer. Also excluded from the category of “covered persons” are publishers of newspapers, magazines or other publications of general circulation that are not registered or required to be registered with the SEC as a broker, dealer or investment adviser.

Exception for “Third Party Research Analysts”

Regulation AC does not apply where a broker, dealer or covered person distributes a research report prepared by a “third party research analyst” whose employer satisfies certain independence criteria. As to a particular broker or dealer, a “third party research analyst” is any research analyst not employed by that broker or dealer or any associated person of that broker or dealer and, with respect to a covered person, is any research analyst not employed by that covered person, by the broker or dealer with whom that covered person is associated, or by any other associated person of the broker or dealer with whom that covered person is associated.

Where a broker-dealer distributes the research of a third party that does not meet these independence criteria, the broker-dealer must confirm that the research report includes the certifications required by Regulation AC. However, broker-dealers who distribute third party analyst research are not required to obtain the public appearance certifications, regardless of the analyst’s independence.

Other Provisions of Regulation AC and the SEC’s Adopting Release

- Regulation AC covers research reports and public appearances relating to both debt and equity securities and, thus, is broader than current rules governing broker-dealers and research analysts.

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- In response to comments to proposed Regulation AC, the SEC has modified the definition of “research report” to expressly include electronic communications.
- The determination whether a written communication falls within Regulation AC’s definition of “research report” is to be based on the “individual facts and circumstances surrounding that communication.” The SEC’s adopting release provides guidance in making this determination.
- Regulation AC requires that only the analyst or analysts “primarily responsible” for the content of a research report comply with the certification requirements. Accordingly, it is not necessary for junior analysts involved in the preparation of a research report to make the certifications.
- Regulation AC does not require certifications during public appearances by analysts.
- With respect to so-called “compendium reports” covering more than one company, if each research analyst is able to certify that
 - the views expressed in the report accurately reflect such research analyst’s personal views about the subject securities and companies; and
 - no part of his compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in the report,then a firm may comply with Regulation AC by including one combined certification.
- In instances where a research report is based on a firm’s quantitative or technical model and not the views of a particular analyst, the firm itself (rather than a particular analyst) may certify that the views expressed in the report accurately reflect the firm’s model, and that no part of the firm’s compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views disclosed in the report.

However, if an analyst’s compensation is tied to the performance of a model (indicating that the report is the result of the analyst’s

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subjective views as reflected in the design of the model), then the analyst must provide the certifications required by Regulation AC with respect to the model's results.

- Regulation AC contains specific provisions regarding its application to foreign research analysts.

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The certifications required by Regulation AC supplement the analyst rules adopted by the New York Stock Exchange and the NASD and approved by the SEC in May 2002. These rules, all of which are now effective, seek to address concerns regarding the potential for conflicts of interest as a result of the relationships between firms' investment banking and research departments. ([Click here to link to our E*Zine regarding the May 2002 analyst rules approved by the SEC.](#))

Please remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact the head of our Corporate and Securities practice group:

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