



September 20, 2002

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, DC 20549-0609

Re: Commission File No. S7-30-02

Dear Mr. Katz:

The Investorside Research Association is pleased to have this opportunity to comment on the proposed Regulation Analyst Certification ("Regulation AC") which seeks to address the pressures on a research analyst's independence and objectivity brought about by investment banking relationships of broker-dealers involved in issuing research reports.

The members of Investorside include the following firms:

Argus Research  
Avalon Research  
Battle Road Research  
BNY Jaywalk, Inc.  
GARP Research  
Investars  
McLean & Partners  
OTA-Off the Record Research

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Schaeffer's Investment Research

Triad Securities

Vista Research

Vickers Stock Research

The Precursor Group<sup>1/</sup>

Investorside is a Washington D.C. based non-profit organization formed to increase investor and pensioner trust in the U.S. capital market system through the promotion and use of investment research that is financially aligned with investor interests. The goals of our organization are to: 1) increase awareness of the financial interests behind investment research; 2) educate investors as to how they can better align investment research with their interests; 3) promote fair representation of investment research to investors; 4) reduce regulatory and industry barriers to competition; and 5) promote "Best Research Payment Practices" such as unbundling research from banking and proprietary trading. Investorside also seeks increased transparency and accountability over how commissions are spent for

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<sup>1/</sup> Certain of the above Investorside members have affiliations with registered broker-dealers.

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research in order that investors will be better able to protect their interests by supporting independent investment research.

Investorside members are required to attest that: 1) they are not in the business of providing investment banking or significant issuer consulting services; 2) they are primarily paid by a client base of investors, not by issuers of securities who are the subject of research; and 3) they are in good standing with all relevant regulatory/governmental authorities.

#### **Our Comments**

Investorside supports the SEC's efforts to improve the independence and objectivity of investment research. However, for the reasons noted below, Investorside submits that by imposing additional burdens on firms producing research which is already independent of investment banking and issuer conflicts, Regulation AC may actually serve as a barrier to entry and an impediment to competition for firms seeking to provide an alternative to traditional sell-side research. Investorside believes that the regulatory scheme should encourage, rather than discourage, the use of research free of conflicts of interest.

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**Regulation AC Should Apply Only to Broker-Dealers  
With Investment Banking Departments**

In the Regulation AC proposing release,<sup>2/</sup> the Commission stated that additional regulation in the area of research reports was warranted because “. . . investment banking relationships and certain compensation arrangements may adversely affect analyst objectivity and, as a result, the integrity of the views expressed in research reports and public appearances.” The application of proposed Regulation AC, however, is not limited to broker-dealers with investment banking departments or other compensation arrangements with issuers who are the subject of research reports, but rather extends to any broker-dealer or associated person of a broker-dealer that publishes, circulates or provides a research report.

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<sup>2/</sup> SEC Release No. 34-46301 (August 2, 2002).

Because of the broad definition of “associated person” under the Exchange Act,<sup>3/</sup> not only would broker-dealers without investment banking departments be swept into Regulation AC=s coverage, but even affiliates of such broker-dealers (e.g., investment advisers, banks, insurance companies) would appear to be subject to the rule, if the investment research produced by these affiliates meets the definition of “research report” under '240.500 of Regulation AC. It is unclear why the Commission would seek to extend new regulatory obligations to such parties, who have not been alleged to have been involved in the abuses publicized in recent months, and who are already subject to a regulatory scheme which would prohibit the dissemination of knowingly false recommendations (e.g., the Investment Advisers Act of 1940 and the anti-fraud provisions of the federal securities laws). To increase regulation on affiliates of broker-dealers who do not have investment banking departments makes even less sense.

While Investorgroup members would certainly be able to make the certifications required by Regulation AC, because our members neither have investment banking departments nor enter into arrangements where they are compensated by the subjects of research reports, subjecting producers of independent research to requirements that were conceived for the purpose of eliminating perceived problems with investment research

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<sup>3/</sup> The term includes “any partner, officer, director, or branch manager of [a] 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 [a] broker or dealer, or any employee of [a] broker or dealer.” Securities Exchange Act '33(a)(18).

produced by full-service broker-dealers with investment banking departments is unnecessary, unduly burdensome, and would tend to discourage, rather than promote, the production of independent research.<sup>4/</sup>

Lumping together independent investor-side research with traditional sell-side research would disserve the investing public in two ways. First, by imposing additional compliance obligations upon investor-side research firms who have not been involved in the types of abuses chronicled in the financial and mainstream press in recent months, Regulation AC would impede the distribution of such independent research to the public by raising compliance costs on firms that cannot subsidize their research through an investment banking department. Second, if investor-side research reports are required to contain the same Regulation AC certifications as research reports produced by full service firms with investment banking departments, investors may wrongly assume that investor-side firms are subject to the same conflicts of interest as firms who engage in investment banking transactions on behalf of issuers who are the subject of research reports. This

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<sup>4/</sup> For example, investor-side research firms and their affiliates, which are traditionally smaller firms with smaller budgets than full-service broker-dealers, would have to hire additional compliance personnel to track public appearances of research analysts to ensure that the certifications required by ' 242.502 are created and stored.

would undermine the work Investorside has been doing to distinguish independent research from traditional, sell-side research, and would also discourage other private-sector competitive solutions for rebuilding investor trust in investment research.

Investorside recommends that broker-dealers who do not have an investment banking department, and thus are free of the potential conflicts attendant thereto, should be exempted from Regulation AC. In this regard, we would suggest that the definition of broker-dealer for the purposes of Regulation AC be limited to a broker-dealer which acts as an underwriter in an offering for an issuer; acts as a financial adviser in a merger or acquisition; provides venture capital, equity lines of credit, PIPEs or similar investments; or serves as placement agent for an issuer.<sup>5/</sup>

**The SEC Should Encourage and Acknowledge Private-Sector Solutions  
to Improve the Quality of Investment Research**

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<sup>5/</sup> Investorside notes that, as discussed in the Commission's proposing release for Regulation AC, potential conflicts faced by broker-dealers who do not have investment banking departments (e.g. disclosure of the receipt of compensation from a company that is the subject of a research report) are already addressed by other laws and regulations, such as recently adopted NYSE Rule 472 and NASD Rule 2711 as well as the anti-fraud provisions of the federal securities laws.

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Both proposed Regulation AC and the recently adopted NYSE and NASD Rules addressing research analyst conflicts of interest have gone a long way towards fulfilling the goals of improving the independence and objectivity of investment research. Investorside believes, however, that private sector initiatives will ultimately be as or more important than regulation in achieving these goals. It is with this thought in mind that Investorside was formed. By promoting "Best Practices" such as the disentanglement of research from investment banking and proprietary trading and by educating investors as to the benefits of research produced by firms independent of such conflicts, Investorside is working to improve the overall quality of investment research available to the public. We believe that the Commission should acknowledge the importance of private-sector initiatives such as Investorside, which seek to restore public confidence in the U.S. securities markets by improving the independence, objectivity and quality of investment research.

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In keeping with the SEC's goals of promoting independence and objectivity in investment research, we ask that the Commission acknowledge in the approval process of Regulation AC the efforts of Investorside, which has been working to find a private-sector solution which will restore investor confidence in investment research. We hope these comments assist the Commission in formulating a modification of Regulation AC which addresses the concerns noted in this letter.

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Sincerely,

Scott C. Cleland  
Chairman  
Investorside Research Association  
CEO of the Precursor Group

John Eade  
Vice Chairman  
Investorside Research Association  
President of Argus Research

cc: Hon. Harvey L. Pitt  
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Hon. Roel C. Campos  
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