



Investorside Research Association Summary of Comments Regarding Amendments to Analyst Certification Rules

Target regulation only where needed:

- Member firms that provide research without investment banking should not be subject to investment banking conflicts of interest regulations.
- Research firms that are not part of the problem should not be captured in an unnecessarily wide net of regulation.

Don't create barriers to competition for pure research providers:

- Investment banking regulation of member firms without research conflicts is unnecessary, overly burdensome, and discriminates against firms free of conflicts.
- One-size-fits-all regulation misrepresents that all research firms have the same conflicts – when some in fact do not – which ill serves investors who are seeking to differentiate and find investment research without conflicts that is aligned with their interests.

Differentiate regulation through certification:

- Investment research certification allows consumers to identify which research firms work for investors and which firms work for companies they cover via their investment banking services.
- Research firms that are certified by government, or through a private sector solution to be free of investment banking conflicts should not be subject to regulations covering investment banking research.

Analyst qualification examinations should not be discriminatory:

- Analysts that work for member firms that do not provide investment banking services should not be subjected to qualification examinations that require expertise in investment banking and proprietary trading practices.
- Unnecessary and inappropriate testing of analysts working for research firms free of conflicts may serve as a barrier to entry and as an impediment to competition for firms seeking to provide an alternative to investment banking research.

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

Re: Commission File No. SR-NASD-2002-154 and SR-NYSE-2002-49

Dear Mr. Katz:

The Investorgroup Research Association is pleased to have this opportunity to comment on the proposed rule changes relating to New York Stock Exchange Rules 344 (“Supervisory Analysts”), 345A (“Continuing Education for Registered Persons”), 351 (“Reporting Requirements”) and 472 (“Communications with the Public”), and relating to the National Association of Securities Dealers’ amendments to Rules 1120 and 2711, and specifically the proposal to create a new NASD rule 1050, which seeks to expand upon recently approved rules that govern analyst conflicts of interest.

The members of Investorgroup include the following firms^{1/}:

Accountability Research

American Technology Research

^{1/} Certain of the above Investorgroup members have affiliations with registered broker-dealers.

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Argus Research

Avalon Research

Battle Road Research

BNY Jaywalk, Inc.

GARP Research

Greenstreet Advisors

Investars

McLean & Partners

OTA-Off the Record Research

Schaeffer's Investment Research

Sidoti & Co.

Triad Securities

Vista Research

Vickers Stock Research

Weiss Ratings

The Precursor Group

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 of investment research

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

In order to be certified for Investorside membership, applicants 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. The purpose of the attestation is to secure the use of the Investorside trademark in commerce to represent a firm as being on the side of Investors. Thus the certification process leverages trademark laws and fair representation and truth in advertising laws to make the certification reliable and robust.

General Comments

Investorside strongly supports the SEC's, NYSE's and NASD's efforts to improve the independence and objectivity of investment research. However, we believe a one-size-fits-all regulatory approach is unwarranted, unnecessarily burdensome and possibly counter productive. Investorside submits that by imposing additional burdens on member firms producing research which is independent of investment banking and other issuer conflicts, the proposed rule changes may actually serve as a barrier to entry and as an impediment to competition for firms seeking to provide an alternative to traditional investment banking research. Furthermore, these rules make it difficult for independent research firms to differentiate their research from that of firms with investment banking or other issuer conflicts. Investorside believes that the regulatory scheme should encourage, rather than discourage, the use of research free of conflicts of interest. In other words, Investorside believes the most competitive and effective solution will rely not only on regulation to minimize the problem of conflicts of interest but will also promote a market solution designed to encourage alignment of interests with investors.

Investorside strongly recommends that member firms producing research that is independent of investment banking and issuer conflicts be regulated differently than traditional sell-side research firms. Investment research firms that are certified to be free of investment banking should not be

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required to adhere to regulations that seek to improve the objectivity of *investment banking-based* research. Creating a separate category of regulation would ensure that member firms free of investment banking conflicts will not be impeded from serving as a competitive alternative to incumbent investment banking research.

Regulations such as NYSE Rules 344, 345A, 351 and 472, and the NASD regulations relating to analyst conflicts of interest and the respective proposed changes relating to these rules, should be targeted to apply only to member firms whose business model creates the basis for possible conflicts by supplying both investment research *and* investment banking or other conflicting services to their clients.

If investor-side research firms are required to follow the same rules and regulations as firms who engage in investment banking or other conflicting transactions on behalf of issuers who are the subject of research reports, investors will be given the false impression that investor-side firms are subject to the same conflicts of interest as those firms. This would countervail the over-arching purpose of these regulations, which is to restore investor trust. This would also undermine the investor-oriented, market-based work Investorside has been doing to distinguish independent research from traditional, sell-side research, and would discourage other private-sector competitive solutions for rebuilding investor trust in investment research. Investorside's mission is complimentary to the purpose of the proposed regulations. In short, Investorside is part of the solution, not part of the problem to be regulated.

Comments Regarding NASD Proposed Rule 1050

As discussed above, when adopting regulations the Commission and the SROs should distinguish between independent research firms and firms with investment banking conflicts. Accordingly we believe associated persons of research firms that provide no investment banking services should not be subject to qualification examination and continued education requirements that require expertise in investment banking and proprietary trading practices (e.g. Series 24 General Securities Principal Examination).

One-size-fits-all broker dealer licensing, which would require pure research broker-dealers to be proficient in investment banking, pre-supposes that all broker-dealers providing research have investment banking conflicts. If the goal is to restore investor trust, is it not in the public interest to distinguish between pure research firms and firms with investment banking conflicts rather than lumping them together?

NASD proposed rule 1050 outlines the need for a new Qualification Examination for Research Analysts that is to be specified by the Board of Governors. Because the term “research analyst” includes persons working for member firms that provide investment research without investment banking conflicts, the proposed “one-size-fits-all” examination would require independent analysts to be subjected to unnecessary, burdensome, and possibly discriminative testing. A better approach would be to target different qualification tests for different business purposes. Analysts associated with research firms without investment banking conflicts would

have one test and those affiliated with firms with investment banking conflicts would have another. A one-size-fits-all approach is akin to arguing that to be an electrician, one must pass both an electrician's and plumber's qualification exam. It's simply a barrier to entry.

Investorside recommends two separate Qualification Examinations be developed for rule 1050, so that research analysts at firms without investment banking services are not unfairly tested on material that has no relation to the services they provide. Unnecessary and inappropriate testing may actually serve as a barrier to entry and as an impediment to competition for firms seeking to provide an alternative to traditional sell-side research.

The Commission should also consider different requirements for businesses serving retail customers vs. institutional investors. Throughout the regulation, there is an implicit and explicit recognition that investment advice targeted to the individual investor requires more qualification than for sophisticated or institutional investors.

Recommendations

Investorside recommends that the Commission, in conjunction with the SROs and state regulators, devise a system for the certification of member firms providing investment research that allows investors to identify whether such firms are also in the business of providing investment banking or other conflicting services.

Investorside strongly believes the investor trust problem is a result of systemic misrepresentation and false advertising of the investment banking model as being free of conflicts of

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interest. Disclosure of conflicts is not enough to restore investor confidence. Fair representation and truthful advertising are needed, and certifications that distinguish between firms who have investment banking conflicts and those who do not would empower consumers to be better and more trusting investors.

Furthermore, research providers that are certified by the Commission, SROs, and states to be free of investment banking conflicts of interest should be exempted from rules and regulations that address conflicts in full-service firms that provide research and investment banking services. In this regard, Investorside requests that the Commission acknowledge private sector certification solutions that seek to differentiate independent research from traditional sell-side research, such as Investorside's certification system.

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Investorside believes that, in crafting regulations, a distinction must be made between research analysts whose member firms engage in investment banking and other conflicting activities and those whose member firms are free of conflicts. The Investorside certification system has been created to find a private-sector solution that will restore investor confidence in investment research by identifying research which is free of conflicts. In keeping with the goals of promoting independence and objectivity in investment research, we ask that the Commission, the NASD and the NYSE acknowledge the Investorside certification system in the approval process of the proposed rule changes to Exchange Rules 344, 345A, 351, and 472, and the NASD Rules relating to analyst conflicts of interest. We hope these comments assist the Commission, the NASD and the NYSE in

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formulating a modification of the Analyst Conflicts rules, which addresses the concerns noted in this letter.

Sincerely,

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

John M. Eade
Vice Chairman
Investorside Research Association
President of Argus Research

cc: Securities and Exchange Commission
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