Securities Industry Association
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May 12, 2003

Sheetal Radia
Business Standards Department
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom

Re: Consultation Paper 171

Dear Mr. Radia:

Thank you for giving the Federal Regulation Committee (the "Committee") of the Securities Industry Association ("SIA")[1] the opportunity to comment on Consultation Paper 171 ("CP 171") of the Financial Services Authority ("FSA"). The issue of research independence has been in the forefront of the agendas of securities regulators in the United States for well over a year. SIA has commented extensively during the adoption process for Regulation AC

[1] The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. Collectively they employ more than 495,000 individuals, representing 97 percent of total employment in securities brokers and dealers. The U.S. securities industry manages the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2001, the industry generated $280 billion in U.S. revenue and $383 billion in global revenues. (More information about SIA is available on its home page: http://www.sia.com.) SIA's Federal Regulation Committee, consisting of over two dozen chief legal officers of securities firms, is SIA's principal legal and regulatory committee.

of the Securities and Exchange Commission, Rule 2711 of the National Association of Securities Dealers ("NASD") and amendments to Rule 472 of the New York Stock Exchange ("NYSE"). We anticipate commenting on additional steps by the regulators to implement requirements of the Sarbanes-Oxley Act of 2002 that bear on this subject. SIA is also closely following the implementation of certain undertakings that 10 major U.S. securities broker-dealers agreed to as part of a comprehensive settlement of enforcement actions brought by the SEC, NASD, NYSE and several state securities regulators.

We share with the Financial Services Authority ("FSA") an appreciation of the need for consistency among different regulatory authorities around the globe, both to enhance the efficiency of global capital markets, and to avoid any possible "forum shopping" for lax regulatory standards. Based on our close observation of the U.S. regulatory experience in this area we offer some thoughts that we hope will be of some value to the FSA in shaping its regulatory approach. Below we comment briefly on some specific paragraphs of CP 171.

4.4 and 4.6 **Internal Management and Supervision**. Presumably the suggestion for information barriers or other controls and procedures for communications between research and sales or trading is spawned by potential conflicts, such as front-running or bolstering proprietary trading. These are understandable concerns, although we think that most regulators, including the FSA, have existing rules that sufficiently address these issues . U.S. regulations do not require information barriers between research and sales or trading, and we do not think such barriers are desirable. Input from sales and trading is often important to analysts in shaping research that will be of maximum use to investors. Moreover, we note that the "Term Sheet" contained in recent settlements in the United States of enforcement actions by state and federal authorities against 10 major U.S. securities firms, while imposing tight restrictions on communications between research and investment banking, expressly permit unfettered communications between research analysts and investment banking departments' equity capital markets groups regarding structuring and pricing of transactions.[2]

4.7 **Soliciting Investment Banking Business**. FSA's statement that analysts should not be involved in pitches for new investment banking mandates is consistent with the approach taken in the Term Sheet. However, the NASD and the NYSE 's proposed amendments to their rules go in a somewhat different direction, barring analysts from writing about a company if they help to solicit certain types of investment banking mandates.[3] Whichever approach is followed, we think that it is critically important for regulators to clarify that they do not intend to proscribe the ability of research analysts to communicate with an issuer prior to receiving an investment banking mandate to determine if the transaction is in the interests of investors. Analysts play an important role in investor protection by helping their firms to make informed decisions at an early stage about investment banking transactions, especially decisions to take a company public. Regulators should take care not to discourage this function.

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[2] *See* I(10)(d) of Exhibit A to complaints against 10 firms, available at http://www.sec.gov/litigation/litreleases/finaljudgadda.pdf ("Term Sheet").

[3] It is not entirely clear if the NASD and NYSE's proposed rule on this point is intended to apply to all investment banking mandates, or just solicitations of initial public offering mandates.

We also think it would be helpful if the FSA would explicitly state that it does not intend to limit in any way analysts' ability to communicate with issuers in the course of performing due diligence once an investment banking mandate has been received. The NASD and NYSE proposed amendments expressly protect this function, and it is puzzling that CP 171 did not recognize it more explicitly.

4.25. **Disclosures**. Most of the disclosures proposed in CP 171 are fairly consistent with U.S. rules. However, there is a notable discrepancy with U.S. rules regarding the required statement as to whether a firm expects to have an investment banking mandate or to manage any issues of securities for a subject company within next 6 months. In the United States, current SRO requirements are limited to whether firm intends to seek or receive compensation for investment banking services in next 3 months. We have questioned the wisdom of the U.S. requirement and we will encourage the US regulators to revisit it in light of experience if our fears that it will create opportunities for insider trading materialize. Consistent with our reservations about the US requirement, we respectfully suggest that the FSA consider withdrawing this particular requirement, replacing it with clear language in research reports warning recipients that they should assume that the firm seeks or intends to seek investment banking business with the subject company. At a minimum, the FSA should make its prospective period 3 months rather than 6.

We have two concerns with this particular form of disclosure. First, disclosure of potential investment banking engagements poses the risk of tipping some of the report's readers about a material non-public

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transaction. A requirement that firms disclose situations where they see a prospect for receiving compensation for investment banking services in a transaction that is not yet public creates the prospect of tipping analysts and/or recipients of their research. This potential tipping of select market participants (analysts and recipients of their research) raises the same social and economic issues that prompted lawmakers and regulators in many nations, including both the United Kingdom and the United States, to develop rigorous laws, regulations and procedures against insider trading together with prophylactic protection for material nonpublic information within a broker-dealer concerning material nonpublic information about corporate transactions.[4]

Our second concern is the compliance challenge of trying to construct a system for tracking whether or not the firm "expects" that it may receive prospective investment banking business. This becomes more difficult (and therefore less accurate, and less useful to investors) the further into the future the requirement extends. We recommend either dropping this particular requirement entirely, or making it consistent with the 3-month US requirement.

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[4] In the United States, *see* Sections 14(e) and 15(f) of the Securities Exchange Act of 1934 ("Exchange Act") (establishing liability for disclosure of material non-public information about corporate transactions), Exchange Act Sections 15(f) and 21A(b) (requiring that broker-dealers maintain internal controls to prevent misuse of such information, and treble-damage liability for failure to do so), *U.S. v. O'Hagan*, 521 U.S. 642 (1997) (liability under Exchange Act Section 10(b) for misappropriating material nonpublic information about corporate transactions), NASD NTM 91-45 and NYSE Information Memo 91-22 (June 28, 1991) (establishing minimum information wall requirements within broker-dealers).

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We very much appreciate the opportunity to comment on CP 171. If you have any questions on any aspect of this letter, please contact George R. Kramer, staff adviser to the Committee, at 011-202-296-9410, or by e-mail to gkramer@sia.com.

Sincerely,

Robert C. Dinerstein, Chairman
SIA Federal Regulation Committee

Cc: Gay Huey-Evans, Financial Services Authority