Strengthening of the JSDA Rule on Securities Analysts in Japan

Financial Services Agency (FSA), Japan

March 2004

Table of Contents

1　The Purpose of the Strengthening of the JSDA Rule on Securities Analysts in March 2004

○　The Japan Securities Dealers Association (JSDA), the SRO under the Securities and Exchange Law, introduced the rule on securities analysts in January 2002. The JSDA strengthened the rule on securities analysts in January 2003 (effective in April 2003) 〈Appendix〉.

○ **The JSDA strengthened again the rule on securities analysts in March 2004 (effective in May 2004), in response to the followings.**

① "IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest" issued by the Technical Committee of the International Organization of Securities Commissions (IOSCO) in September 2003

② The recommendation issued by the Securities and Exchange Surveillance Commission of Japan to FSA issued in December 2003 regarding the necessity to address conflicts of interest that independent securities analysts may face

2　Major Points of the Revision of the JSDA Rule on Securities Analysts in March 2004

①　Prohibiting analysts from participating in investment banking sales pitches and road shows

- *This is in line with the "IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest."*
- *Detailed rule and interpretations to deal with this issue are described. (referred in Pages 6&7)*

②　Introducing measures to address the conflicts of interest that independent securities analysts may face

- *Some securities companies make a contract with "independent analysts" (outside analysts) that does not belong to securities companies, and use analysts report written by the "independent analysts". Measures are introduced to deal with this issue. (referred in Pages 8～10)*
- *These are in line with the recommendation issued by the SESC.*

3 Measures to address the "IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest"

(1) Prohibiting securities analysts from participating in investment banking sales pitches and road shows

○ A member firm is required to take measures for the followings.

① Securities analysts should not get engaged in sales pitches regarding businesses of the underwriting division or the investment banking division.

② Officers or employees in the underwriting division or the investment banking division should not involve or endeavor to involve securities analysts and independent securities analysts to sales pitches regarding businesses of the underwriting division or the investment banking division.

③ Securities analysts should not be involved in road shows.

④ Officers or employees in the underwriting division or the investment banking division should not involve or endeavor to involve securities analysts and independent securities analysts in road shows.

(2) Prohibiting analysts from covering an issuer in cases the analysts serve as directors or officers etc.

- A member firm is required to prohibit securities analysts to cover an issuer in cases the analysts serve as directors, officers, or members of the issuer’s supervisory board.

(3) Prohibiting analysts from holding securities of the issuers that they cover

- A member firm is explicitly required to prohibit securities analysts in principles to hold securities of the issuers that they cover.

4 Measures to Address the Recommendation Issued by the SESC

【Introduction of Measures concerning Independent Securities Analysts】

○ When a member firm makes a contract with independent analysts and use the analyst reports written by them, the member firm is required to take measures including the followings.

① The member firm is required to disclose conflicts of interest situation of the independent analysts in relation to subject companies in the analyst reports concerned.

② In case the member firm paid for or promised to pay for producing the analyst reports by the independent analysts, the member firm is required to disclose such fact to their customers or in the analyst reports concerned.

③ In case the member firm chooses the subject companies of the analyst reports that would be written by the independent analysts, the member firm is required to disclose such fact to their customers or in the analysts reports concerned.

④ In case a member firm paid for or promised to pay for the analyst reports or in case a member firm choose the subject companies of the analyst reports that would be written by the independent analysts, the member firm is required to take the following measures.

- If there is a material conflicts of interest between a member firm and the subject companies of the analyst reports, the member firm is required to disclose such fact to its customers or in the analyst reports.

- If a member firm has become a lead manager for the offering of shares, stock subscription rights or corporate bonds with stock subscription rights, and if an independent analyst that made contract with the member firm publishes analyst reports covering the issuing company's stock within one year from the date of the filing of securities registration statements, the member firm is required to disclose such fact to its customers or in the analyst reports.

⑤　When a member firm makes a contract with independent analysts and uses the analyst reports written by them, the member firm is required to confirm if appropriate measures are taken to ensure fair and proper business of the independent analysts in terms of securities holding or trading of the independent analysts.

Major points of the strengthened JSDA Rule on Securities Analysts in January 2003

1) Research independence

- Securities analysts must be institutionally independent from the investment banking departments. Especially, securities analysts' compensation should not be linked to the performance of the investment banking businesses.

2) Disclosure of conflicts of interest

- Member firms are required to disclose any conflicts of interest situation of themselves and their research analysts in relation to subject companies.

3) Prohibition of the pre-disclosure to the subject company

- Member firms are prohibited to disclose research reports to subject companies before their publications.

4) Review process of the research report

- Member firms are required to establish review processes which ensures integrity and objectivity of research reports.

5) Strict control of information

- Information obtained through research processes is required to be appropriately controlled.

6) Maintenance requirement of the research reports

- Members are required to maintain research reports for 3 years after their publications.