Testimony Concerning Global Research Analyst Settlement

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U.S. Securities and Exchange Commission

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Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee:

Thank you for inviting me to testify today concerning the recently-announced global research analyst settlement among the Commission, the New York Stock Exchange (NYSE), National Association of Securities Dealers, (NASD), the New York Attorney General (NYAG), other state regulators and ten Wall Street firms. I appreciate having the opportunity to discuss this important subject with you.

I. Introduction

Last week, the Commission announced enforcement actions against, and simultaneous settlements with, ten broker-dealers and two individuals for failing to ensure that the research they provided their customers was independent and unbiased by investment banking interests.[1] The settlements of these actions, which were brought in conjunction with proceedings by the NASD, the NYSE, the NYAG, and other states, extract significant monetary relief from the firms, including penalties that rank among the highest ever paid in civil securities enforcement actions. These landmark penalties

[1] The 10 firms are: Bear, Stearns & Co. Inc. (Bear Stearns), Credit Suisse First Boston LLC (CSFB), Goldman, Sachs & Co. (Goldman), Lehman Brothers Inc. (Lehman), J.P. Morgan Securities Inc. (J.P. Morgan), Merrill Lynch, Pierce, Fenner & Smith, Incorporated (Merrill Lynch), Morgan Stanley & Co. Incorporated (Morgan Stanley), Citigroup Global Markets Inc., f/k/a Salomon Smith Barney Inc. (SSB), UBS Warburg LLC (UBS), and U.S. Bancorp Piper Jaffray Inc. (Piper Jaffray). The individuals are Jack B. Grubman and Henry M. Blodget.

reflect the serious nature of the misconduct, as well as the Commission's belief that securities firms must hold the interests of their customers paramount. The Commission is continuing to investigate the roles played by individual securities analysts and their supervisors.

Although the monetary relief secured in the settlements is substantial, unfortunately the losses that investors suffered in the aftermath of the market bubble that burst far exceed the ability to compensate them fully. They can never fully be repaid. Moreover, their loss was more than monetary. It was also a loss of confidence and a loss of the hopes and dreams they had built over a lifetime. And although the monetary relief obtained in the settlements is record-breaking, the structural reforms required are, in many ways, more significant and far-reaching. In that regard, the settlements include important requirements designed to insulate research analysts from pressures by investment banking.

The research analyst settlements also require firms to provide investors with independent, third-party research whenever they solicit investors to purchase securities that are covered by a firm's own research. Certain firms will provide funding for investor education initiatives designed to arm investors with the knowledge and skills they need to make informed investment decisions. Taken together, the numerous obligations the Commission imposes on the defendants will fundamentally change the role and perception of research at Wall Street firms. Indeed, these reforms will go a long way towards restoring the honorable legacy of the research profession.[2]

The research analyst settlements mark an important milestone in the

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[2] Under the terms of the settlements, injunctions will be entered against each of the firms and individuals, enjoining them from violating the statutes and rules that they are alleged to have violated. The proposed Final Judgments in the SEC actions are subject to Court approval.

Commission's investigation, and in its regulatory initiatives to help ensure that research provided to investors is objective. They bring to a close a period during which the once-respected research profession became nearly unrecognizable to earlier generations of investors and analysts. However, the settlements are but one component of the Commission's ongoing efforts to restore investors' faith in the fairness of the securities markets. The Commission continues to move forward aggressively in combating financial fraud, overseeing the start-up of the Public Company Accounting Oversight Board, and implementing the Sarbanes-Oxley Act, to mention just a few of the Commission's other priorities.

With that overview, I would like to use the remainder of the testimony to: (1) review the Commission's activities in the analyst conflicts area; (2) describe the charges filed last week; (3) explain the terms of the settlements in some detail; and (4) discuss the Commission's ongoing regulatory activities in this area.

II. Background

The Commission's involvement in the area of research analyst conflicts, of course, pre-dates the global settlement. The SEC began to examine this issue in 1999. The Commission staff was concerned that analysts, who had became veritable media stars, appearing ubiquitously on television financial programs, did not disclose their own conflicts of interest so that investors could evaluate their recommendations against their possible biases. Accordingly, in the summer of 1999, staff from the SEC's Division of Market Regulation began a review of industry practices regarding disclosure of research analyst's conflicts of interest. Then, staff from the Office of Compliance Inspections and Examinations (OCIE) conducted examinations of the largest full-service firms on the

Street. The examinations focused on analysts' financial interests in companies they covered, as well as analyst compensation arrangements and reporting structures, in particular whether analysts reported to investment banking personnel.

The SEC reported the findings of those examinations in summer 2001 at a hearing of the House Financial Services Subcommittee on Capital Markets entitled *"Analyzing the Analysts: Are Investors Getting Unbiased Research from Wall Street?"* The findings outlined in the Commission's testimony included:

- It was commonplace for research analysts to provide research reports on companies that the analysts' employer firm underwrote.

- Many firms paid their analysts largely based upon the profitability of the firms' investment banking units.

- Investment bankers at some firms were involved in evaluating the firm's research analysts to determine their compensation.

- Some firms maintained policies prohibiting analysts from owning stock in companies they covered. Other firms permitted analysts to own stock in companies they covered but prohibited them from executing personal trades that were contrary to the analysts' outstanding recommendations.

- Compliance with Self Regulatory Organization (SRO) rules that require firms to monitor the private equity investments of employees, including analysts, was poor. Firms did not always know whether their research analysts owned stock in companies about which their analysts issued research reports.

As a result of the Commission's examination findings, and given the serious concerns about the conflicts of interest analysts face that may taint or bias their recommendations, in fall 2001, the Commission called on the NASD and NYSE to work together to craft new rules intended to restore investor confidence in analysts' work. These rules were designed to address the conflicts of interest identified by the SEC. They were first proposed and aired for public comment in February 2002.

Then, on May 10, 2002, the Commission approved sweeping rule amendments by the NYSE and NASD addressing analyst conflicts. The amendments closed a number of regulatory gaps and took considerable steps towards promoting greater independence of research analysts by, among other things:

- prohibiting tying analyst compensation to specific investment banking transactions;
- restricting personal trading by analysts in securities of companies followed by the analyst;
- prohibiting offering favorable research to induce firm business;
- restricting investment banking review of research reports; and
- defining quiet periods on the issuance of research reports.

The Commission enacted or approved additional rules to bolster the integrity of analyst research, which are described in Section V below.

The Commission was also concerned that investors were simply not aware of these conflicts of interest. To help address this problem, in 2001, the Commission issued an Investor Alert highlighting the numerous biases that may affect analyst recommendations. The Alert, called *"Analyzing Analyst Recommendations,"* explained to investors the relationships between securities analysts and the investment banking and brokerage firms that employ them, and educated investors about potential conflicts of interest analysts may face.

On April 8, 2002, New York Attorney General Eliot Spitzer commenced an action in New York state court pursuant to New York's Martin Act against Merrill Lynch & Co. Inc., Henry M. Blodget, and several other Merrill Lynch analysts. In papers filed with the state court, the NYAG alleged that since late 1999, the internet research analysts at

Merrill Lynch had published ratings for internet stocks that were misleading in that, among other things, the reports did not reflect the analysts' true opinions and Merrill Lynch did not disclose that the ratings were affected by conflicts caused by the analysts' ties to investment banking. The NYAG included with his filing dozens of exhibits, including internal Merrill Lynch e-mails demonstrating the analysts' conflicts of interest.

The NYAG reached a settlement with Merrill Lynch on May 21, 2002, pursuant to which the firm agreed to pay a penalty of $100 million and, among other things, to sever the link between compensation for analysts and investment banking, prohibit investment banking input into analysts' compensation, create a new investment review committee responsible for approving all research recommendations, establish a monitor to ensure compliance with the agreement, and disclose in Merrill Lynch's research reports whether it received or was entitled to receive any compensation from a covered company over the previous 12 months.

In the meantime, on April 25, 2002, the Commission announced that it had commenced a formal inquiry into market practices concerning research analysts and the potential conflicts that can arise from the relationship between research and investment banking. The inquiry was to be conducted jointly with the NYSE, the NASD, the NYAG, the North American Securities Administrators Association (NASAA) and the states. The purpose of the inquiry was to determine whether any laws had been violated as well as the necessity of additional rulemaking.

In October 2002, the Commission, the NYAG, the NYSE, the NASD and NASAA announced a joint effort to bring to a speedy and coordinated conclusion the various investigations concerning research analysts and IPO allocations. The

Commission and other participating regulatory entities intended, based on the evidence they had compiled, to formulate a common plan to address conflict-of-interest and other issues pertaining to research analysts and IPO allocations. The plan was to be used as a template to structure appropriate settlements with the firms that were currently under investigation and/or to provide a sound basis for proposing industry-wide rules and regulations (including structural reforms).

In December 2002, then-Chairman Harvey L. Pitt, New York Attorney General Spitzer, NASAA President Christine Bruenn, NASD Chairman and CEO Robert Glauber, NYSE Chairman Dick Grasso, and state securities regulators announced an historic settlement-in-principle with the nation's top investment firms to resolve issues of conflict of interest at brokerage firms. Following the announcement, the Commission staff worked diligently with other regulators and the firms to finalize the settlement-in-principle. The broad principles agreed to in December are reflected in the terms of the final settlements approved by the Commission, and announced last week.

The following sections describe the charges against the defendants and the terms of the settlements.

III. The Charges Filed Against the 12 Defendants

A. Charges Against the Firms

The charges against the ten firms, which the firms neither admit nor deny, are summarized below.

The Commission's complaints charge that CSFB, Merrill Lynch and SSB issued fraudulent research reports in violation of Section 15(c) of the Securities Exchange Act of 1934 as well as various state statutes. For example, according to the complaint filed against CSFB, internal e-mail correspondence among research analysts regarding a particular company shows that the pressure imposed by investment bankers on research analysts to initiate or maintain favorable coverage was not an isolated problem at CSFB. In May 2001, a technology research analyst wrote an e-mail to the Head of Technology Research, complaining of "Unwritten Rules for Tech Research: Based on the following set of specific situations that have arisen in the past, I have 'learned' to adapt to a set of rules that have been imposed by Tech Group banking so as to keep our corporate clients appeased. I believe that these unwritten rules have clearly hindered my ability to be an effective analyst in my various coverage sectors."

In another example, according to the complaint filed against SSB, on the same day that SSB and Jack Grubman published a research note rating a particular company as a 1 (Buy), Grubman e-mailed two colleagues that he believed that company should be rated a 4 (Underperform). In the e-mail, he also characterized the company as a "pig."

The Commission's complaints charge that Bear Stearns, CSFB, Goldman, Lehman, Merrill Lynch, Piper Jaffray, SSB and UBS Warburg issued research reports that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about the covered companies, and/or contained opinions for which there was no reasonable basis in violation of NYSE Rules 401, 472 and 476(a)(6), NASD Rules 2110 and 2210, as well as state ethics statutes.

The Commission's complaints further charge that UBS Warburg and Piper Jaffray received payments for research without disclosing such payments in violation of Section 17(b) of the Securities Act of 1933 as well as NYSE Rules 476(a)(6), 401 and 472 and

NASD Rules 2210 and 2110. Those two firms, as well as Bear Stearns, J.P. Morgan and Morgan Stanley, are charged with making undisclosed payments for research in violation of NYSE Rules 476(a)(6), 401 and 472 and NASD Rules 2210 and 2110 and state statutes.

CSFB and SSB are also charged with engaging in inappropriate spinning of hot IPO allocations in violation of SRO rules requiring adherence to high business standards and just and equitable principles of trade, and the firms' books and records relating to certain transactions violated the broker-dealer record-keeping provisions of Section 17(a) of the Securities Exchange Act of 1934 and SRO rules (NYSE Rule 440 and NASD Rule 3110).

All ten firms are charged with failing to maintain appropriate supervision over their research and investment banking operations in violation of NASD Rule 3010 and NYSE Rule 342.

B. Charges Against the Individuals

The charges against the two individual defendants, Henry M. Blodget and Jack B. Grubman, which they neither admit nor deny, are summarized below.

The SEC alleges that, during 1999 through 2001, Blodget issued research reports that were materially misleading because they were contrary to his privately expressed negative views. The SEC also alleges that Blodget issued research reports that were not based on principles of fair dealing and good faith, did not provide a sound basis for evaluating facts regarding the subject companies, and contained exaggerated or unwarranted claims about those companies.

As to Grubman, the SEC alleges that, during 1999 through 2001, Grubman issued several fraudulent research reports that contained misstatements and omissions of material facts about the companies, contained recommendations contrary to his actual views regarding the companies, overlooked or minimized the risk of investing in these companies, and predicted substantial growth in the companies' revenues and earnings without a reasonable basis. The complaint against Grubman further alleges that he issued numerous research reports that were not based on principles of fair dealing and good faith, did not provide a sound basis for evaluating facts regarding the subject companies, and contained exaggerated or unwarranted claims about those companies.

IV. Terms of the Settlements

To impress upon the firms the seriousness with which the Commission and other regulators regard their misconduct, and to help restore investors' faith in the objectivity of research, the settlements employ a multi-pronged approach, including both monetary and non-monetary forms of relief.

A. Monetary Relief

Collectively, the settling firms will pay disgorgement and civil penalties totaling $875 million, including Merrill Lynch's previous payment of $100 million in connection with its prior settlement with the states. Under the settlement agreements, half of the $775 million payment by the firms other than Merrill Lynch will be paid in resolution of actions brought by the SEC, NYSE and NASD, and will be put into funds to benefit customers of the firms (the "Distribution Funds"). The remainder of the funds will be paid to the states. The Commission has invited the states to contribute their portions of the civil penalties and disgorgement to the funds for investors as well.

1. Penalties

The civil penalties in these actions, which total $487.5 million, are among the highest – and the $150 million civil penalty against Salomon Smith Barney is the highest – ever imposed in civil securities enforcement actions. Pursuant to the settlements, the firms may not seek to treat the civil penalties as tax deductible or eligible for reimbursement under their insurance policies. In addition, the Commission intends that the federal regulators' portion of the civil penalties be added to the Distribution Funds, pursuant to the Fair Funds provision of the Sarbanes-Oxley Act, for repayment to harmed investors.

2. Disgorgement

The ten settling firms will pay $387.5 million in disgorgement. The federal regulators' portion of these funds will be used to establish Distribution Funds to provide recompense to harmed investors.[3] While there are challenges and difficulties in administering such Funds, the Commission feels strongly that those challenges and difficulties are worth taking on and that any funds paid by the settling firms should be used to compensate the investors harmed most directly by the misconduct uncovered in the investigations. The Commission believes this is the right thing to do, and is consistent with the message sent by Congress when it recently authorized the Commission to use penalties to repay investors.

The Distribution Funds will be administered by a Court-appointed "Distribution Fund Administrator," who will distribute them in an equitable, cost-effective manner to customers who purchased equity securities of companies referenced in the complaint

[3] The total amount of the Distribution Funds will be $399 million, which includes the federal regulators' share of the disgorgement and penalties paid by the firms and by the two individual defendants.

against the firm through which the customer bought the securities. However, the funds will not necessarily be allocated (i) with respect to purchases of stock of *each* company identified in the SEC's complaints; or (ii) to *all* purchasers of stock of a company identified in the complaints. Under the settlement agreements, it is intended that there be an equitable -- but not necessarily equal -- distribution of funds and that those who are allocated funds receive meaningful payments from the Distribution Funds. A recipient of funds from these settlements is not precluded from pursuing, to the extent otherwise available, any other remedy or recourse against a firm.

All of the Distribution Fund Administrator's fees, costs, and expenses, including all the fees, costs, and expenses of persons the Distribution Fund Administrator hires to assist him or her, will be paid by the settling firms and not from the Distribution Funds. Investors will not have to bear any of this expense. The only amounts from the Distribution Funds that will not be paid to investors are income taxes on the interest earned by the Distribution Funds and an additional amount, also payable from the interest earned by the Distribution Funds, to be paid to the Court. Both of these payments are required by law.

3. *Tax and Insurance Issues Relating to the Settlement Payments*

Some members of Congress have expressed interest in and concern about the tax and insurance treatment of the settlement payments. As alluded to above, the Commission included language in these settlements that expressly prohibits the firms from taking a tax deduction or seeking to recover from an insurance carrier the penalty portions of their payments. The SEC has never imposed such requirements before, and to our knowledge, no other civil enforcement program typically does this. It was important to do this here, however, because when it comes to penalties, the public policy imperative -- in the tax code and in court decisions interpreting insurance policies -- is very clear: penalties ought to be paid by those upon whom they are imposed and should not be deductible.

With respect to the tax treatment of disgorgement payments – which are a well-accepted remedy in civil enforcement actions and whose treatment under the tax code has long been understood by Congress – we did not think it wise for us to substitute our judgment for that of Congress or the IRS. With respect to the tax treatment of the independent research and investor education payments, it did not seem appropriate to call them something that they were not in order to obtain a particular tax treatment or insurance result. In this regard, during the negotiation of the settlement, the Commission staff at no time engaged in "horse trading" by agreeing to lower penalty or disgorgement payments in return for higher independent research or investor education payments.

As for the insurability of disgorgement and the independent research and investor education payments, the issues are complicated and it likely will be up to the courts to determine, as a matter of state law, whether they are insurable.

B. Structural Reforms

Although the monetary relief obtained in the settlement is record-breaking, the structural reforms required by the settlement are, arguably, more significant and far-reaching. Specifically, the settlements include important requirements designed to insulate research analysts from pressures by investment banking. For instance, the firms will separate research and investment banking, including physical separation, completely separate reporting lines, separate legal and compliance staffs, and separate budgeting processes.

In addition, under the terms of the settlement, analysts' compensation cannot be based directly or indirectly upon investment banking activities or input from investment banking personnel. Investment bankers cannot evaluate analysts, and an analyst's compensation will be based in significant part on the quality and accuracy of the analyst's research. To help ensure compliance, decisions concerning compensation of analysts will be documented.

Moreover, there will be no overlap between the jobs of investment bankers and research analysts. Investment bankers will have no role in determining what companies are covered by the analysts, and research analysts will be prohibited from participating in efforts to solicit investment banking business, including pitches and road shows. Firms also will implement policies and procedures reasonably designed to assure that their personnel, including banking personnel, do not seek to influence the contents of research reports for purposes of obtaining or retaining investment banking business.

To ensure that the separation between investment banking and research is comprehensive, firms will create and enforce firewalls between the two operations reasonably designed to prohibit improper communications between the two. Communications will be limited to those enabling research analysts to fulfill a "gatekeeper" role.

To ensure that these reforms are executed and implemented in a meaningful way, each firm will retain, at its own expense, an Independent Monitor who is acceptable to the SEC to conduct a review of the firm's compliance with the structural reforms. This review will be conducted eighteen months after the date of the entry of the Final

Judgment, and the Independent Monitor will submit a written report of his or her findings to the SEC, NASD, and NYSE within six months after the review begins.

C. Enhanced Disclosures

The settlements also impose a series of requirements that will benefit investors by providing them better information concerning the limitations of research. In that regard, each firm will include a disclosure on the first page of each research report stating that it "does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report." In addition, when a firm decides to terminate \ coverage of an issuer, it will issue a final research report discussing the reasons for the termination. To enhance investors' power as consumers, each quarter, each firm will publish on its website a chart showing its analysts' performance, including each analyst's name, ratings, price targets, and earnings per share forecasts for each covered company. These disclosures will fuel development of private services to transform such raw data into investor-friendly report cards on the accuracy of the firms' research, which should enable customers to comparison-shop for research.

D. Independent Research

Another innovative and forward-looking aspect of the settlement agreements is the requirement that the firms purchase independent, third-party research for their customers. For a five-year period, each of the firms will be required to contract with no fewer than three independent research firms that will make available independent research to the firm's customers. Firms will notify customers of the availability of independent research on their customer account statements, on the first page of research reports, and on the firm's website. An independent consultant for each firm will have final authority to procure independent research, and will report annually to regulators concerning the research procured. Payments for independent research will total $432.5 million.

E. <u>Investor Education</u>

To better arm investors to cope with the risks inevitably associated with participating in the capital markets, the settlement also provides for the establishment of an Investor Education Fund of $80 million. This initiative is particularly important because it has meaning beyond the context of this investigation. The SEC, NYSE and NASD have authorized that $52.5 million of these funds be put into an Investor Education Fund to support programs designed to equip investors with the knowledge and skills necessary to make informed investment decisions. The Court will appoint an SEC-recommended Investor Education Fund Administrator to establish a non-profit grant administration program to fund worthy and cost-efficient investor education programs. The remaining $27.5 million will be paid to state securities regulators, which they will use for investor education purposes.

F. <u>Voluntary Initiative Regarding Initial Public Offerings</u>

In addition to the terms imposed by the regulators, the firms have collectively entered into a *voluntary* agreement restricting allocations of securities in "hot" IPOs – offerings that begin trading in the aftermarket at a premium – to certain company executive officers and directors, a practice known as "spinning." The Commission intends to evaluate the need for specific rulemaking in this area, in light of these and other recent Commission enforcement actions that indicate abuses in the IPO allocation process.

G. Individual Settlements

The terms of the settlements with the individual defendants are as follows:

Former Merrill Lynch analyst Henry M. Blodget, in settlement of the charges against him,[4] which he neither admits nor denies, has agreed to pay $2 million in penalties (which he may not treat as tax deductible or seek to recover from an insurance carrier or other third party) and an additional $2 million in disgorgement (all of which will be placed in the Distribution Funds). Blodget also has agreed to a federal court order that will enjoin him from future violations of the federal securities laws and NASD and NYSE rules. Blodget also will be censured and permanently barred from associating with any broker, dealer, or investment adviser.

Former SSB analyst Jack B. Grubman, in settlement of the charges against him,[5] which he neither admits nor denies, has agreed to pay $7.5 million as disgorgement and an additional $7.5 million in penalties (which he may not treat as tax deductible or seek to recover from an insurance carrier or other third party). One-half of these amounts will be placed in the Distribution Funds. Grubman also has agreed to a federal court order that will enjoin him from future violations of the federal securities laws and NASD and NYSE rules. Grubman also will be censured and permanently barred from associating with a broker, dealer, or investment adviser.

V. Regulatory Actions to Address Analyst Conflicts and IPO Spinning

In addition to its enforcement activities, the Commission and the self-regulatory

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4 The action against Henry Blodget is being brought in conjunction with actions by the NASD and NYSE.

5 The action against Jack Grubman is being brought in conjunction with actions by the NASD, NYSE and NYAG.

organizations have taken action through rulemaking to require securities firms to better minimize, manage, and disclose analyst conflicts. These rules are designed to improve the objectivity and independence of research analysis and ensure that conflicts of interest that may affect research are disclosed to investors.

A. Regulatory Initiatives Relating to Research Analysts

As described in Section II, in May 2002, the Commission approved sweeping rule amendments by the NYSE and NASD addressing analyst conflicts. Early this year, the Commission published a second set of proposed rule changes filed by the NYSE and NASD to further strengthen their analyst conflicts rules. The Commission expects to act on those proposed amendments by the end of July.

The proposed amendments would, among other things:

- further reduce the influence of investment banking on analyst compensation;
- prohibit the issuance of research reports by the manager or co-manager of a securities offering for fifteen days prior to and after the expiration of lock-up agreements ("booster shots").
- restrict analyst involvement in solicitation activities with issuers ("pitch meetings"); and
- provide investors with notice of a firm's intention to terminate coverage of a company.

As you know, on July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act directs the Commission to implement rules designed to further address research analyst conflicts of interest. The Act requires that such rules must be adopted by the end of July. The Commission has been working with the SROs to meet the directives of the Act.

In addition to SRO rule changes, the Commission adopted its own rule, Regulation Analyst Certification, which became effective on April 14th of this year. Regulation AC requires that broker-dealers, and certain associated persons who distribute research reports, obtain certifications from their research analysts that the views expressed in research reports and public appearances accurately reflect the analyst's personal views and whether the analyst received compensation for their recommendations or views.

B. *Regulatory Initiatives Relating to IPO Spinning*

As you are aware, the IPO underwriting process has come under considerable scrutiny during the past year -- especially with regard to perceived abuses in the allocation of IPO shares. During the technology-stock boom of the late 1990s, it was not uncommon for a "hot IPO" to quadruple in value on its first day of trading (in some cases increasing by as much as 700%). These IPOs were typically heavily oversubscribed and participation in these IPOs became immensely valuable for both underwriters and customers.

This hot commodity produced huge first-day returns for those who received allocations in the IPOs, but also led to abusive conduct, including a practice known as "spinning." Spinning involves the allocation of "hot" IPO shares to senior executives in the belief or expectation of receiving future investment-banking business from their companies. The problem with IPO spinning is that the broker-dealer is not distributing all the shares of hot IPOs into the market, but is using some shares to entice investment-banking business from insiders of other corporations. Spinning increases the public perception that IPO allocations are an insiders' game. Spinning also raises serious questions about whether the corporate insiders who take hot IPO shares in exchange for their firms' investment banking business are breaching their fiduciary duties to their shareholders.

The global settlement includes a voluntary ban on the allocation of "hot" IPOs to executive officers and directors of public companies. The Commission is reviewing industry practices regarding the allocation of IPO shares with the goal of restoring investor confidence and public trust.

In addition, last Fall, at former Chairman Pitt's request, the NYSE and NASD convened a Blue Ribbon Panel of business and academic leaders to conduct a broad review of the IPO process, including the role of issuers and underwriters in the pricing and allocation process, and recommend ways to improve the underwriting process. We understand that the panel hopes to report on its findings shortly.

The NASD recently sought comment from its members on its proposed new rules regarding the regulation of IPO allocations and distributions. These rules are intended to better ensure that members avoid unacceptable conduct when they engage in the allocation and distribution of IPOs. Among other things, the rules would prohibit allocations to company CEOs and directors on the condition that they send their companies' investment banking business to the NASD member.

In the months ahead, the Commission will continue to examine the IPO practices of the industry to determine whether further Commission or SRO action is necessary, including the possibility of revising existing rules or proposing new rulemaking.

VI. Conclusion

In conclusion, let me assure you that throughout the research analyst investigation and the process of negotiating the global settlement, the goals of the Commission and its staff have been to protect investors and restore confidence in our securities markets. The Commission will monitor carefully the effects of, and compliance with, the terms of the settlement, and take actions as appropriate to ensure that these objectives are achieved. In addition, the Commission intends to review the implementation of the settlement, along with reforms adopted by the Commission and the NASD and NYSE over the last two years, to evaluate whether additional, harmonizing, or superseding rules are appropriate.

Thank you again for inviting me to speak on behalf of the Commission. I would be happy to answer any questions that you may have.