

analyst's compensation.⁴⁰ Others requested confirmation that a research analyst's compensation could be based not only on a member's overall profitability, but also on the profitability of a firm's capital markets division, investment banking department, or an industry group within an investment banking department, and requested that the SROs explicitly acknowledge certain additional permissible compensation factors set forth in the Global Settlement.⁴¹

The SROs agree that the general financial success of a member may be considered in determining analyst compensation.⁴² NASD does not believe that it would be appropriate for a member to determine a research analyst's compensation based upon the profitability of the member's capital markets division, investment banking department, or some subgroup of such a division or department.⁴³ NASD acknowledges that several other factors may be appropriate to consider when determining compensation, the rules do not attempt to list all possible permissible considerations, and the NASD does not think it necessary to do so.⁴⁴

Several commenters argued that the SRO rules should adopt the Global Settlement approach by applying obligations concerning how to calculate compensation only for the "lead analyst" (those analysts that are required to provide certifications under Regulation AC).⁴⁵ As such, commenters argued that the compensation committee provision should apply only to the compensation of analysts who are primarily responsible for a research report's substance.⁴⁶

Upon consideration of commenters' concerns, the SROs agree that such a limitation on the scope of this provision is reasonable, and filed amendments to apply the compensation restrictions only to those research analysts who are primarily responsible for the preparation of the substance of a research report.⁴⁷ Thus, research analysts who are not primarily responsible for a research report's substance, such as junior analysts who report to the lead analyst, would not be

covered by the compensation committee provision.

Commenters requested clarification on the intended role of the compensation committee and asserted that the proposed language was unclear as to whether the appropriate role of the committee was to "review and approve" research analyst compensation or to "determine" research analyst compensation; the commenter argued that the appropriate role for the committee should be to serve a review and approval function.⁴⁸

The SROs amended the proposals to require that research analyst compensation be reviewed and approved by the compensation committee.⁴⁹ The amendments clarify that the committee must review and approve a research analyst's compensation. With the exception of the prohibitions of NYSE Rule 472(b)(1) and NASD Rule 2711(b)(1) on research analysts being subject to compensatory evaluation by investment banking personnel, the rules do not address who may initially determine that compensation.

The SOA requires that the "compensatory evaluation" of research analysts be limited to "officials employed by the broker or dealer who are not engaged in investment banking activities."⁵⁰ In order to satisfy the mandates of the SOA, the SROs have filed amendments to prohibit employees of the member's investment banking department from evaluating the compensation of research analysts.⁵¹ As such, investment banking department personnel may not have input in determining research analyst compensation. Unlike the compensation committee provisions, this prohibition applies to the compensatory evaluation of all research analysts, and is not limited to those research analysts that are primarily responsible for the preparation of the substance of a research report.

The Commission notes that neither the current nor proposed SRO rules prohibit the consideration of the revenues or results of the firm as a whole in determining research analyst compensation.⁵² The NASD has

recognized that a research analyst, as part of his or her professional duties, may advise his or her firm's investment banking department concerning certain matters, such as whether a potential underwriting client is prepared for an initial public offering.⁵³ Therefore, for example, NASD has stated that such activities may be considered in determining an analyst's compensation; however, it may not be given undue weight relative to evaluating the quality of other research work product.⁵⁴

The Commission believes that the proposed compensation committee amendments are consistent with the SOA and promote the alignment of investor interests with those of research analysts who are primarily responsible for the preparation of the content of research reports by requiring that the committee, in reviewing and approving research analyst compensation, consider the quality of the research product and the correlation between the research analyst's recommendations and the stock price performance. The Commission also believes that the proposed prohibition on investment banking input regarding the compensatory evaluation of all research analysts is an important restriction in reducing the influence of investment banking interests on research analysts, and satisfies the mandates of Section 15D of the Exchange Act. The Commission also finds that the amendments relating to research analyst compensation are consistent with the Exchange Act, including Sections 6(b)(5), 6(b)(8), 15A(b)(6), and 15A(b)(9).

C. Definition of "Research Report" [NYSE Rule 472.10(2) and NASD Rule 2711(a)(8)]

Several commenters expressed concern regarding the proposals' amended definitions of "research report."⁵⁵ The proposals adopt the SOA definition of "research report" by eliminating the current definitional requirement that a research report contain a "recommendation." The NASD Rule 2711 and NYSE Rule 472 contain substantially similar amended definitions of "research report," defining the term as a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and provides information reasonably

revenues. See NYSE Rule 472(h)(1) and (2), and NASD Rule 2711(d)(2).

⁵³ See NASD Response to Comments.

⁵⁴ *Id.*

⁵⁵ See BOA letter, CSFB letter, Schwab March 20th letter, SIA March 10th letter, Stifel letter, Sullivan letter, and Wilmer March 11th letter.

⁴⁰ See SIA May 9th letter and Sullivan letter.

⁴¹ *Id.*

⁴² See NYSE 472(h)(1) and NASD Response to Comments.

⁴³ See NASD Response to Comments.

⁴⁴ *Id.*

⁴⁵ See SIA May 9th letter and Sullivan letter.

⁴⁶ See SIA March 10th letter.

⁴⁷ See NASD Response to Comments and NYSE Amendment No. 3.

⁴⁸ See SIA March 10th letter.

⁴⁹ See NYSE Rule 472(h)(2) and NASD Rule 2711(d)(2).

⁵⁰ See 15 U.S.C. 78o-6(a)(1)(B).

⁵¹ See Amendment No. 3.

⁵² The SROs' rules permit consideration of firm revenues as a whole, so long as a research analyst's compensation is not based on a specific investment banking transaction, and so long as the member discloses in research reports if the research analyst received compensation that is based upon (among other factors) the member's investment banking