

period¹⁴³ to be consistent with the SOA's client disclosure provision,¹⁴⁴ which imposes this timeframe for disclosure of a client relationship with the subject company. In addition, the current requirement in the SRO rules for disclosure of investment banking compensation is also based on this timeframe.¹⁴⁵

Several commenters were strongly critical of this proposed amendment.¹⁴⁶ In particular, these commenters asserted that requiring disclosure of non-investment banking compensation received by a member and its affiliates from the subject company would be extremely burdensome and complex, and therefore not in the public interest. Commenters expressed heightened concerns regarding the difficulties of tracking affiliate compensation received from the subject company.¹⁴⁷ They argued that real-time tracking of such compensation would be unduly burdensome and asserted that firms would be unable to implement a real-time tracking system capable of 100% accuracy with regard to disclosure of affiliate compensation.¹⁴⁸ Commenters argued that the SRO proposals did not give effect to the SOA requirements that the mandated rules be "reasonably designed to address conflicts of interest," and would provide little useful information to investors.¹⁴⁹ Commenters recommended that the SROs adopt a narrower version of this proposal that would tie disclosure of the receipt of compensation by a member or its affiliates from a subject company to the research analyst's knowledge of such compensation.¹⁵⁰

As noted by commenters, the SOA mandates disclosure of conflicts of interests that are "known or should have been known"¹⁵¹ by the analyst or

broker or dealer, and the SROs agree that the proposals should be modified to reflect this qualification.¹⁵² Accordingly, the SROs revised their proposals in several respects regarding the disclosure of non-investment banking compensation received by the member or affiliates from the subject company.

While the original proposals implied that "real-time" disclosure was required, the modified proposals provide for periodic disclosure in certain circumstances. For example, if the member received any non-investment banking compensation from the subject company, the proposals require disclosure as of the end of the month immediately preceding the date of publication of the research report. Real time disclosure would only be required if the analyst or an employee of the member with the ability to influence the substance of the research report ("influential employee") possesses actual knowledge of such member non investment banking compensation.¹⁵³

The SROs revised their proposals to require disclosure in research reports of affiliate non-investment banking compensation of which the analyst or influential employee knows,¹⁵⁴ or of which the analyst or member or has reason to know.¹⁵⁵

The modified SRO proposals respond to commenters' concerns by requiring disclosure in research reports of affiliate non-investment banking compensation of which the analyst or member "has reason to know."¹⁵⁶ The proposals create two mechanisms by which analysts and members may satisfy the disclosure requirements relating to what the analyst or member would have reason to know about affiliate non-investment banking compensation.¹⁵⁷

The rules provide that this disclosure requirement will be deemed satisfied if the member has taken steps reasonably designed to identify affiliate non-investment banking compensation during that calendar quarter and discloses such in research reports within 30 days after completion of the last calendar quarter.¹⁵⁸ In the

alternative, the proposals provide that a member and analyst would be presumed not to have a reason to know of affiliate non-investment banking compensation from the subject company, if the member maintains and enforces policies and procedures reasonably designed to prevent the analyst and any influential employee from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.¹⁵⁹ If such procedures are maintained and enforced by the member, then the member and analyst would be presumed not to have reason to know of affiliate non-investment banking compensation. However, because this is a presumption of a lack of knowledge, to the extent that the research analyst or an employee of the member with the ability to influence the substance of a research report obtains actual knowledge of affiliate non-investment banking compensation, disclosure would be required under NASD Rule 2711(h)(2)(A)(iv) and NYSE Rule 472(k)(1)(ii)(b)(2).

Unlike the original proposals, which required absolute disclosure of any compensation received by the member and its affiliates, the revised proposals would limit certain of the disclosure requirements to the actual knowledge of research analysts and influential employees, and in cases where the analyst or member has reason to know. Thus, real-time tracking by the member non-investment banking compensation may not be necessary.

Commenters have argued that all of the compensation disclosure requirements should be tied to the knowledge of the research analyst or supervisor.¹⁶⁰ However, the SROs do not agree.¹⁶¹ Certain of the disclosure requirements, such as the receipt of investment banking compensation to the member or its affiliates from the subject company, are not tied to the knowledge of specific individuals, but require that the firm track the receipt of such compensation sufficient to make affirmative disclosures where warranted.¹⁶² The SOA also requires that disclosure of firm and affiliate compensation be made by research analysts in public appearances.¹⁶³ Therefore, the SRO proposals require the disclosure of any compensation

¹⁴³ See NYSE Rule 472(k)(1)(i)(d)(2) and NASD Rule 2711(h)(2)(A)(iii)(a).

¹⁴⁴ See 15 U.S.C. 78o-6(b)(3).

¹⁴⁵ See NYSE Rule 472(k)(1)(i)(a)(2) and NASD Rule 2711(h)(2)(A)(ii)(b).

¹⁴⁶ See BOA letter, Schwab June 30th letter, SIA June 26th letter, and Wilmer June 25th letter.

¹⁴⁷ See BOA letter and Wilmer June 25th letter.

¹⁴⁸ The Commission notes that, in requiring disclosure of any compensation, the SOA did not mandate, and the SRO proposals do not require, that broker-dealers disclose how much compensation was received, but rather requires affirmative disclosure (if such is the case) of whether any compensation has been received.

¹⁴⁹ See SIA June 26th letter and Wilmer June 25th letter.

¹⁵⁰ *Id.*

¹⁵¹ The SROs use "have reason to know" in their proposals, because that language appears in other related rules. However, the SROs interpret "have reason to know" as having the same meaning as "should have been known" as used in the Section 501(b) of the SOA. 17 U.S.C. 78o-6(b). See NASD Response to Comments and NYSE Amendment No. 3.

¹⁵² See NASD Response to Comments and NYSE Amendment No. 3.

¹⁵³ See NYSE Rule 472(k)(1)(i)(d)(2) and (k)(1)(ii)(b)(2), and NASD Rule 2711(h)(2)(A)(iii)(a).

¹⁵⁴ See NYSE Rule 472(k)(1)(ii)(b)(2) and NASD Rule 2711(h)(2)(A)(iv).

¹⁵⁵ See NYSE Rule 472(k)(1)(iii)(a) and NASD Rule 2711(h)(2)(A)(v).

¹⁵⁶ See NYSE Rule 472(k)(1)(ii)(b)(2) and NASD Rule 2711(h)(2)(A)(v).

¹⁵⁷ See NYSE Rule 472(k)(1)(iii)(a)(1) and (2), and NASD Rule 2711(h)(2)(a)(v)(a) and (b).

¹⁵⁸ See NYSE Rule 472(k)(1)(iii)(a)(1) and NASD Rule 2711(h)(2)(a)(v)(a).

¹⁵⁹ See NYSE Rule 472(k)(1)(iii)(a)(2) and NASD Rule 2711(h)(2)(a)(v)(b).

¹⁶⁰ See SIA June 26th letter and Wilmer June 25th letter.

¹⁶¹ See NASD Response to Comments and NYSE Amendment No. 3.

¹⁶² This requirement is part of the original amendments. See NYSE Rule 472(k)(1)(i)(a)(2) and (3), and NASD Rule 2711(h)(2)(A)(ii)(b) and (c).

¹⁶³ See 15 U.S.C. 78o-6(b).