

compensation is appropriate to address concerns regarding the dissemination of material non-public information regarding specific potential future investment banking services transactions of the subject company. Finally, the Commission believes that the SRO rules, by providing an exemption in the client disclosure provision fulfill the SOA mandate to adopt rules reasonably designed to provide disclosure of broker-dealers' clients and client services, while appropriately addressing concerns related to the potential dissemination of material non-public information.

In the Joint Memorandum, the SROs provided guidance that "knows or has reason to know" requires disclosure of such information of which the analyst has actual knowledge, as well as such information that should be reasonably discovered in the ordinary course of business. The SROs note that they expect that a research analyst would have reason to know of disclosures made in prior research reports.¹⁸⁷ In addition, a research analyst would have reason to know of such information by virtue of the steps taken by the member or member organization to identify compensation received by a client pursuant to proposed NYSE Rule 472(k)(1)(iii)(a)(1) and NASD Rule 2711(h)(2)(A)(v)(a).¹⁸⁸

The SOA also mandates rules requiring disclosure of compensation received by a research analyst from the subject company.¹⁸⁹ Current SRO rules do not expressly require such disclosure. To the extent that receipt of such compensation constitutes an actual, material conflict of interest, the SROs believe that disclosure would be required under NASD Rule 2711(h)(1)(C) and NYSE Rule 472(k)(1)(iii)(d). The SROs proposed amendments specifically require disclosure of any compensation received by an analyst from the subject company in the past 12 months.¹⁹⁰

The Commission believes that the proposed SRO compensation disclosure amendments are appropriate and satisfy the mandates of the SOA. Several commenters expressed concern regarding the difficulty of tracking non-investment banking compensation, especially that of member affiliates.¹⁹¹ The Commission believes that the SROs have significantly modified the rule amendments from proposal in a manner

that addresses commenters' concerns regarding the difficulties presented by real-time tracking of non-investment banking compensation, while meeting the requirements of the SOA. In summary, the Commission finds that the SRO rules relating to disclosure by the broker-dealer and research analyst in research reports and public appearances of broker-dealer, research analyst, and affiliate compensation from subject companies satisfy the requirements of Section 15D(b)(2) of the Exchange Act¹⁹² in that they are reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the analyst, from the issuer that is the subject of the appearance or research report, that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report.

The Commission also believes that the proposed provisions regarding disclosure of whether the subject company is a client of the broker-dealer and the services provided satisfy the requirements of the SOA. The Commission also finds that the proposals are consistent with the Exchange Act, including Sections 6(b)(5), 6(b)(8), 15A(b)(6) and 15A(b)(9).

J. Registration and Continuing Education Requirements [NYSE 344 and 345A; NASD 1050 and 1120]

The proposed amendments would mandate certain registration requirements for research analysts who are primarily responsible for the preparation of the substance of research reports. The proposals would impose both the regulatory element and the firm element of the continuing education requirements on research analysts.¹⁹³

Commenters expressed several concerns with this proposal. First, commenters requested clarification that the registration and qualification requirements apply only to research analysts who are primarily responsible for the substance of a research report.¹⁹⁴ Second, commenters recommended that research analysts who have a certain level of industry experience, or who have already attained a commonly used industry qualification, be exempt from

the qualification examinations.¹⁹⁵ Commenters also argued that research analysts who work for members that are not engaged in investment banking activities should be exempt from the proposed requirements.¹⁹⁶

In response to these comments, the SROs modified their proposals so that the registration and qualification requirements apply only to research analysts who are primarily responsible for the preparation of the substance of research reports or whose name appears on research reports; therefore, junior analysts would not be required to register. The SROs are also considering whether there are certain classes of research analysts, who otherwise would be required to comply, that should be exempted from portions of the qualification requirements.¹⁹⁷ However, because the qualification examination will cover, in part, the provisions of NASD Rule 2711 and the research analyst provisions of NYSE Rule 472, the NASD has indicated that it is unlikely that any current research analysts will be wholly exempt from all parts of the qualification examination.¹⁹⁸ The SROs are also considering whether they will accept, as a substitute, other industry qualification exams in place of the new research analyst qualification exam.¹⁹⁹

Commenters also noted that the NASD and the NYSE proposals differed as to whether the regulatory element component of their continuing education requirements applies to research analysts.²⁰⁰ After further consideration, the SROs have agreed that research analysts should be required to complete both the regulatory element and the firm element of the continuing education requirements.²⁰¹ The NYSE has modified its proposals accordingly.

The Commission finds that these proposals are consistent with the Exchange Act, particularly Sections 6(b)(5), 6(b)(8), 15A(b)(6) and 15A(b)(9).

K. Retaliation [NYSE Rule 472(g)(2) and NASD Rule 2711(j)]

The SOA mandates the establishment of rules that prohibit broker-dealers engaged in investment banking activities from directly or indirectly

¹⁹⁵ See AIMR March 6th letter, Schwab March 20th letter, and SIA March 10th letter.

¹⁹⁶ See Investorside letter.

¹⁹⁷ See NASD Response to Comments and NYSE Amendment No. 3.

¹⁹⁸ See NASD Response to Comments.

¹⁹⁹ See NASD Response to Comments and NYSE Amendment No. 3.

²⁰⁰ See SIA March 10th letter.

²⁰¹ See NASD Response to Comments and NYSE Amendment No. 3.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ See 15 U.S.C. 78o-6(b)(2).

¹⁹⁰ See NYSE Rule 472(k)(2)(ii)(a)(1) and NASD Rule 2711(h)(2)(A)(i)(b).

¹⁹¹ See BOA letter, SIA June 26th letter, and Wilmer June 25th letter.

¹⁹² 15 U.S.C. 78o-6(b)(2).

¹⁹³ See note 15 *supra*.

¹⁹⁴ See SIA March 10th letter.