

## **Regulation AC Supporting Statement**

### **A. Justification**

#### **1. Necessity of Information Collection**

In 1999, the Commission and Congress closely examined research analysts' conflicts of interest. There was particular concern that many investors who rely on analysts' recommendations may not know, among other things, that favorable research coverage could be used to market the investment banking services provided by an analyst's firm, and that an analyst's compensation may be based significantly on generating investment banking business. Moreover, news reports stated that some analysts had issued reports that did not reflect their true beliefs and communicated to institutional investors views that differed materially from those expressed in their research reports.

Regulation AC is intended to address these issues. It complements other rules governing conflicts of interest disclosure by research analysts, including NYSE Rule 472, NASD Rule 2711, and the anti-fraud provisions of the federal securities law.

Regulation AC requires that research reports published, circulated, or provided by a broker or dealer or covered person contain a statement attesting that the views expressed in each research report accurately reflect the analyst's personal views and whether or not the research analyst received or will receive any compensation in connection with the views or recommendations expressed in the research report. Regulation AC also requires broker-dealers to, on a quarterly basis, maintain records of research analyst statements regarding whether the views expressed in public appearances accurately reflected the analyst's personal views, and whether any part of the analyst's compensation is related to the specific recommendations or views expressed in the public appearance. Regulation AC also requires that research prepared by foreign persons be presented to U.S. persons pursuant to Securities Exchange Act Rule 15a-6 and that broker-dealers notify associated persons if they would be covered by the regulation. Regulation AC excludes the news media from its coverage.

#### **2. Purpose of, and Consequences of Not Requiring, the Information Collection**

Regulation AC focuses on core issues of analysts' integrity, their beliefs in their recommendations and the influence of compensation on their recommendations. It is important for an investor to know whether an analyst may be biased with respect to securities or issuers that are the subject of a research report. Further, in evaluating a research report, it is reasonable for an investor to want to know about an analyst's compensation. The information collections of Regulation AC further these purposes by making disclosures of these issues to investors. Without the information collection, the purposes of Regulation AC could not be met.

**3. Role of Improved Information Technology and Obstacles to Reducing Burden**

The Commission is not aware of any technical obstacles to reducing the burden through the use of improved information technology.

**4. Efforts to Identify Duplication**

The information required by Regulation AC does not duplicate that required by any other federal regulation.

**5. Effects on Small Entities**

Regulation AC's requirements are closely related to information, procedures, and disclosures required by existing SRO rules, which apply to both large and small broker-dealers that publish or circulate research reports. The Commission believes that the requirements of Regulation AC are not unduly burdensome on small entities.

**6. Consequences of Less Frequent Collection**

Less frequent collection of information would deprive investors of important information regarding whether an analyst potentially is biased with respect to securities or issuers that are the subject of each research report or public appearance, as well as information regarding an analyst's compensation with respect to recommendations or views expressed in each research report or public appearance. Regulation AC is reasonably designed to prevent acts and practices that are fraudulent, deceptive, or manipulative.

**7. Inconsistencies With Guidelines in 5 CFR 1320.5(d)(2)**

The collection of information requested in the rules described herein is conducted in a manner consistent with the guidelines in 5 C.F.R.1320.5(d)(2).

**8. Consultations Outside the Agency**

Not applicable.

**9. Payment or Gift to Respondents**

Not applicable.

**10. Assurance of Confidentiality**

No assurance of confidentiality is provided.

## 11. Sensitive Questions

No questions of a sensitive nature are asked.

## 12. Estimates of Respondent Reporting Burden

### a. Certifications of Research Reports

The Commission believes that the average amount of time it takes a broker-dealer to include the required certifications and disclosures in each research report is one minute per report. The Commission estimates that broker-dealers publish approximately 657,000 research reports per year. Therefore, the Commission estimates that the total annual burden in hours for all broker-dealers to comply with the research report certification and disclosure requirements is approximately 10,950 hours per year [(1 minute x 657,000 reports) / 60 minutes]. The Commission estimates that the hourly pay rate for a research analyst in 2008 was approximately \$359 per hour.<sup>1</sup> Therefore, the Commission estimates that the total annual internal cost for broker-dealers to comply with the research report certification and disclosure requirements is approximately \$3,931,050 per year [10,950 hours x \$359].

Rule 501 of Regulation AC, which applies to research reports, may also impose requirements on certain entities if they are associated with a broker-dealer and meet the definition of “covered person.” The Commission estimates that approximately 2,914 SEC registered investment advisers are associated with a broker-dealer. The Commission believes that not all of these entities write research reports, and that those who do write research reports write relatively few. Of those investment advisers that are associated with a broker-dealer and that write research reports, we do not believe that all of them will meet the definition of a “covered person.” As a conservative estimate, however, if all SEC registered investment advisers are covered persons and on average publish as many research reports per year as the average broker-dealer (250 research reports), the estimated total number of research reports published by SEC registered investment advisers who are associated with a broker-dealer is approximately 728,500 [250 x 2,914]. Therefore, the Commission estimates that the total annual analyst certification burden in hours for these investment advisers is approximately 12,142 hours [(1 minute x 728,500 research reports) / 60 minutes]. The Commission estimates that the annual internal cost of complying with the research report certification and disclosure requirements for SEC registered investment advisers is approximately \$4,358,978 per year [12,142 hours x \$359].

Therefore, the total annual number of responses for the research report certification and disclosure requirements is approximately 1,385,500 [657,000 research reports per year published by broker-dealers + 728,500 research reports per year published by SEC registered investment advisers who are associated with a broker-dealer]. The total annual burden in hours of complying with the research report certification and disclosure requirements is 23,092 hours [10,950 hours for broker-dealer compliance + 12,142 hours for “covered person” compliance].

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<sup>1</sup> The \$359/hour figure for a research analyst is from SIFMA’s *Management & Professional Earnings in the Securities Industry 2007*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

The total annual internal cost of complying with the research report certification and disclosure requirements is \$8,290,028 [\$3,931,050 for broker-dealer compliance + \$4,358,978 for “covered person” compliance].

**b. Quarterly Statements on Public Appearances**

The Commission estimates that the average amount of time it takes a research analyst to prepare the quarterly statements regarding public appearances is ten minutes per analyst. The Commission believes that, on average, approximately 519 public appearances by research analysts occur per quarter, or about 2,076 appearances per year. Therefore, the Commission believes that the total annual burden in hours of complying with the quarterly statements on public appearances requirement is approximately 346 hours per year [(10 minutes x 2,076 appearances) / 60 minutes]. The Commission estimates that the total annual internal cost of complying with the quarterly statements on public appearances requirement is approximately \$124,214 [346 hours x \$359].

**c. Notifications of Associated Persons**

Rule 504 of Regulation AC requires a broker-dealer to notify its associated persons that issue research reports as to whether associated persons would meet the definition of “covered persons” under Regulation AC, and therefore, be subject to the rule. For PRA purposes, the below calculations represent the Commission’s estimates of the amount of time that would be required for broker-dealers to comply with Rule 504. The Commission estimates that there are approximately 2,914 investment advisers that are associated with at least one broker-dealer. The Commission estimates that it takes approximately one hour per year for each of the approximately 2,914 broker-dealers to determine whether it maintains and enforces written policies and procedures reasonably designed to prevent the broker or dealer or any of its controlling persons, officers, or employees from influencing the activities of research analysts and the content of research reports prepared by associated persons. The Commission estimates that it takes approximately thirty minutes per year for each broker-dealer to determine whether its associated persons have any officers or employees in common with the broker or dealer who can influence the activities of research analysts or the content of research reports and, if so, the identity of those persons. The Commission estimates that it takes fifteen minutes per year for each broker-dealer to draft and provide the required notification to its associated persons. Therefore, the Commission estimates that the annual burden for broker-dealers of complying with the notifications of associated persons requirement is approximately 5,100 hours [(2,914 x 105 minutes) / 60]. The Commission expects that a compliance officer will likely be the employee primarily charged with making the necessary determinations, and drafting and providing the required notification. The Commission estimates that the hourly pay rate for a compliance officer in 2008 was approximately \$414 per hour.<sup>2</sup> The Commission estimates that the annual internal cost of complying with the notifications of associated persons requirement in dollars would be approximately \$2,111,400 [5,100 hours x \$414].

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<sup>2</sup> The \$414/hour figure for a compliance officer is from SIFMA’s *Management & Professional Earnings in the Securities Industry 2007*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

**d. Total Reporting Burden**

The Commission estimates that the total annual number of respondents is approximately 5,186 [estimated number of research analysts employed in the U.S.].<sup>3</sup> The Commission estimates that the total annual number of responses is approximately 1,390,490 [1,385,500 responses for the research report certification and disclosure requirements + 2,076 responses for the quarterly statements on public appearances requirement + 2,914 responses for the notifications of associated persons requirement].

The Commission estimates that the regulation results in a total annual burden of approximately 28,538 hours [23,092 hours for the certifications of research reports requirements + 346 hours for the quarterly statements on public appearances requirement + 5,100 hours for the notifications of associated persons requirement]. Therefore, the Commission estimates that the regulation results in a total annual internal cost in dollars of approximately \$10,525,642 [\$8,290,028 for the certifications of research reports requirements + \$124,214 for the quarterly statements on public appearances requirement + \$2,111,400 for the notifications of associated persons requirement].

**13. Estimates of Total Annualized Cost Burden**

Not applicable; (a) it is not anticipated that respondents will have to incur any capital and start up cost to comply with Regulation AC; (b) it is not anticipated that the respondents will have to incur any additional operational or maintenance cost (other than provided for in Item no. 12 above) to comply with the rule.

**14. Estimated Cost to the Federal Government**

The government does not experience significant costs based on the recordkeeping required pursuant to Regulation AC. The information collected by the respondents may be reviewed only pursuant to an investigation, not as a matter of routine.

**15. Explanation of Changes in Burden**

The changes in burden reflect the incorporation of two requirements imposed by Regulation AC which were not included in the FY 2005 recertification. First, Rule 501 imposes requirements on certain entities if they are associated with a broker-dealer and meet the definition of “covered person.” The Commission estimates that the total annual burden in hours for the approximately 2,914 registered investment advisers which are associated with a broker-dealer to comply with this

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<sup>3</sup> The Commission has used the total number of research analysts employed in the U.S. to estimate the total number of respondents under the rules. This figure serves as the best indicator of the total number of respondents since the event triggering Regulation AC responsibilities, the creation of research reports, is performed by research analysts.

requirement is approximately 12,142 hours. No such estimate was included in the FY 2005 recertification. Second, Rule 504 requires a broker-dealer to notify its associated persons that issue research reports as to whether associated persons would meet the definition of “covered persons” under Regulation AC, and therefore, be subject to the rule. The Commission estimates that the annual burden for broker-dealers to comply with this notification requirement is approximately 5,100 hours. No such estimate was included in the FY 2005 recertification. While there has not been an increase in the number of respondents, the Commission estimates that respondents generally have increased activities that trigger collection of information requirements under Regulation AC, thereby increasing the estimated number of responses per year

**16. Information Collection Planned for Statistical Purposes**

Not applicable.

**17. Explanation of Why Expiration Date Will Not Be Displayed**

Not applicable.

**18. Exceptions to the Certification**

Not applicable.

**B. Collecting Information Employing Statistical Methods**

Not applicable.