

## **SUPPORTING STATEMENT**

### **For the Paperwork Reduction Act Information Collection Submission for Regulation AC**

#### **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, FINRA Rules 2241 and 2242 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 personal views of the analyst(s) primarily responsible for preparing the report. Also the report must specify 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, on a quarterly basis, to maintain records of research analyst statements regarding whether the views expressed in public appearances by the analyst(s) primarily responsible for preparing the report 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 Use of 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. Consideration Given to Information Technology**

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

### **4. 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 Not Conducting Collection**

Failing to collect this 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)**

There are no special circumstances. This collection is consistent with the guidelines in 5 C.F.R.1320.5(d)(2).

### **8. Consultations Outside the Agency**

The Commission received one comment in response to its solicitation of comments from the public on this collection of information. The Securities Industry and Financial Markets Association (SIFMA) commented that its members believe the Commission has underestimated the burden of making and tracking the statements that certain research analysts are required to make and that brokers and dealers are required to compile on a quarterly basis in connection with certain public appearances by research analysts. SIFMA said that the Commission underestimated the costs in three areas: 1) the number of active research analysts; 2) the average number of public appearances per year by those analysts; and 3) the amount of time spent by research analysts to make the statements

required by Regulation AC and for brokers and dealers to make a quarterly record of those statements.

1) The number of active research analysts: The Financial Industry Regulatory Authority (FINRA) is a self-regulatory organization for registered brokers and dealers. FINRA rules require that any person associated with a FINRA-registered broker or dealer who is to function as a research analyst must register as a research analyst. A registered research analyst must have a Series 86/87 license issued by FINRA.

In its comment, SIFMA suggests that there may be 7,350 analysts who have Series 86/87 licenses; however SIFMA acknowledged that it did not know whether those persons were active analysts. FINRA advised that, as of April 2, 2018, there were 5,935 persons who had active Series 86/87 licenses. For purposes of estimating the number of research analysts who might be required under Regulation AC to make statements regarding their public appearances, using the number of persons with active licenses most likely over-estimates the number of research analysts required to make such statements for the following reasons: 1) not all the persons with active licenses are working as research analysts; 2) not all of the persons working as research analysts will be “lead” analysts required to certify their research reports under Regulation AC as the person primarily responsible for the content of the report; 3) not all of the research analysts whose research reports are circulated by a broker or dealer will make a public appearance providing information and/or discussing their views and recommendations.

Using the number of persons with an active Series 86/87 license as a high-end estimate for the number of research analysts who are required to make statements regarding their public appearances is over-inclusive of the number of research analysts actually making public appearances. Nevertheless, that number is a conservative estimate and the Commission will use that figure when adjusting its estimate of the potential costs of statements and recordkeeping regarding research analysts’ public appearances.

2) The number of public appearances by research analysts: As noted above, only certain research analysts are required to make certifications with regard to certain public appearances. Brokers or dealers are only required to make a quarterly record of such public appearances. The Commission’s previous estimates were that 40% of research analysts made an average of one public appearance per year.

SIFMA’s comment references a survey of its “Research Committee,” but does not provide either a copy of the survey results or any details regarding the members surveyed other than that it involved firms of varying sizes. SIFMA states that its survey suggests that each research analyst makes an average of 11-15 public appearances per year. The high end of SIFMA’s suggested average for public appearances is less than 4 public appearances per quarter per analyst. The Commission will use the mid-range figure of 13 to adjust its estimates of the potential number of public appearance research analyst certifications annually. This is a conservative estimate given that not all persons with active research analyst licenses are making public appearances covered by Regulation AC .

3) The amount of time spent to prepare research analysts’ certifications and the quarterly list of public appearances: The Commission estimated that for each quarterly list, it takes a research analyst 10 minutes to compile a list of their public appearances during that quarter, including making the required statements. SIFMA’s estimates of an annual average of 11-

15 public appearances per research analyst (less than 4 appearances per quarter) is consistent with the Commission’s estimates of analysts’ time spent on these statements and lists. SIFMA states that “compliance” in “some firms” can take as many as 60-80 hours per quarter “to compile, vet, and reconcile” the quarterly lists of analysts’ statements. However, as noted above, SIFMA did not provide the survey nor did it provide details sufficient for the Commission to evaluate and factor those figures into its cost estimates.

SIFMA states that the public appearance certifications are of minimal benefit because Regulation AC also has analyst certification requirements for research reports. This assertion ignores, for example, the passage of time between the certification of a research report and the research analyst’s public appearance, during which intervening events could change the analyst’s views on the company.

SIFMA also states that the statements and certifications required by Regulation AC are duplicative of FINRA rules governing disclosure of certain listed conflicts of interest for research analysts and/or their firms. As noted in section A.1. above, the FINRA rules governing research analysts are complementary to Regulation AC. Neither of the FINRA rules require an analyst to certify that his/her true beliefs are reflected in the recommendations and information provided in his/her research reports and public appearances. Also the definition of public appearance in Regulation AC differs from those in the FINRA rules.

SIFMA recommends that Regulation AC be amended “to remove the requirement to obtain quarterly analyst statements related to public appearances.” This comment is beyond the scope of the Paperwork Reduction Act; any changes to Regulation AC would require a separate rulemaking.

The Commission is adjusting its cost estimates in response to SIFMA’s comment, and has made changes to paragraphs 12b and 12d below.

## **9. Payment or Gift**

Not applicable.

## **10. Confidentiality**

No assurance of confidentiality is provided.

## **11. Sensitive Questions**

No questions of a sensitive nature are asked. The information collection does not collect any Personally Identifiable Information (PII).

## **12. Information Collection 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 2018 is approximately \$476 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 \$5,212,200 per year [10,950 hours x \$476].

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 2,459 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 614,750 [250 x 2,459]. Therefore, the Commission estimates that the total annual analyst certification burden in hours for these investment advisers is approximately 10,245 hours [(1 minute x 614,750 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 \$4,876,620 per year [10,245 hours x \$476 ].

Therefore, the total annual number of responses for the research report certification and disclosure requirements is approximately 1,271,750 [657,000 research reports per year published by broker-dealers + 614,750 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 21,195 hours [10,950 hours for broker-dealer compliance + 10,245 hours for “covered person” compliance]. This burden is a reporting burden. The total annual internal cost of complying with the research report certification and disclosure

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<sup>1</sup> The \$476 /hour figure for a research analyst is from SIFMA’s *Management & Professional Earnings in the Securities Industry 2013*, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

requirements is \$10,088,820 [\$5,212,200 for broker-dealer compliance + \$4,876,620 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. Based on the information provided in SIFMA’s comment with regard to its estimates of the average number of public appearances by research analysts per year, the Commission adjusted its estimates of the number of public appearances upward to approximately 19,288 public appearances by research analysts per quarter, or about 77,155 public appearances per year. As discussed in paragraph 8 above, the Commission believes that using to total number of persons who hold active FINRA research analyst licenses to estimate the number of research analysts who might have to make quarterly statements on public appearances overestimates the number of potential respondents. However, the Commission is taking a conservative approach to its costs estimates; with those qualifications the Commission estimates that the total annual burden in hours of complying with the quarterly statements on public appearances requirement is approximately 12,859 hours per year [(10 minutes x 77,155 appearances) / 60 minutes]. This is a recordkeeping burden. The Commission estimates that the total annual internal cost of complying with the quarterly statements on public appearances requirement is approximately \$6,120,884 [12,859 hours x \$476].

**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 2,459 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 2,459 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 4,303 hours [(2,459 x 105 minutes) / 60]. This is a third-party disclosure burden. 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 2018 is approximately \$511 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 \$2,198,833 [4,303 hours x \$511].

#### **d. Total Reporting Burden**

As discussed in paragraphs 8 and 12b, the Commission has adjusted upward the number of potential respondents to reflect estimates the number of persons who have active FINRA research analyst licenses. Although the adjustment most likely over-estimates the number of potential respondents, the Commission is using that figure (5,935) as the total annual number of respondents for this filing.<sup>3</sup> With those qualifications, the Commission estimates that the total annual number of responses is approximately 1,351,364 [1,271,750 responses for the research report certification and disclosure requirements + 77,155 responses for the quarterly statements on public appearances requirement + 2,459 responses for the notifications of associated persons requirement].

The Commission estimates that the regulation results in a total annual burden of approximately 38,357 [21,195 hours for the certifications of research reports requirements + 12,859 hours for the quarterly statements on public appearances requirement + 4,303 hours for the notifications of associated persons requirement]. Therefore, the Commission estimates that the regulation results in a total annual internal cost of compliance of approximately \$18,408,537 [\$10,088,820 for the certifications of research reports requirements + \$6,120,884 for the quarterly statements on public appearances requirement + \$2,198,833 for the notifications of associated persons requirement].

### **13. Costs to Respondents**

Not applicable; (a) it is not anticipated that respondents will have to incur any capital and start-up costs 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. Costs to the Federal Government**

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<sup>2</sup> The \$511 /hour figure for a compliance officer is from SIFMA's *Management & Professional Earnings in the Securities Industry 2013*, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

<sup>3</sup> The Commission has used the total number of research analysts that hold active FINRA research analyst registrations to estimate the total number of respondents under the rules. Although this figure most likely over-estimates the actual number of research analysts who are actually required to certify reports, it is a reasonable indicator of the total number of respondents since the event triggering Regulation AC responsibilities is the creation of research reports.

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. Changes in Burden**

The increase in hour burden from 25,395 hours to 38,357 hours reflects an increase in the Commission's estimate of the number of investment advisors that are associated with broker-dealers, an upward adjustment in the number of potential respondents, an upward adjustment in the number of public appearances per analyst, and an increase in the total annual number of responses.

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

Not applicable. The information collection is not used for statistical purposes.

## **17. Approval to Omit OMB Expiration Date**

The Commission is not seeking approval to omit the expiration date..

## **18. Exceptions to Certification for Paperwork Reduction Act Submissions**

This collection complies with the requirements in 5 CFR 1320.9.

## **B. COLLECTING INFORMATION EMPLOYING STATISTICAL METHODS**

This collection does not involve statistical methods.