



Invested in America

December 15, 2014

By Electronic Mail to rule-comments@sec.gov

Brent J. Fields
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Nos. SR-FINRA-2014-047 & SR-FINRA-2014-048; Release Nos. 34-73622 & 34-73623: SIFMA Comment on FINRA Proposed Rule Changes to Adopt FINRA Rule 2241 and FINRA Rule 2242, Relating To Equity and Debt Research Analysts and Reports

Dear Mr. Fields:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to respond to the request for comment by the U.S. Securities and Exchange Commission (the “Commission”) in the above-referenced Notices of Filing of a Proposed Rule Change, published in the Federal Register on November 24, 2014 (the “Releases”).² The Releases contain proposals by the Financial Industry Regulatory Authority (“FINRA”) to adopt FINRA Rule 2241 (Research Analysts and Research Reports, “Proposed Rule 2241”) and FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports, “Proposed Rule 2242”), and together with Proposed Rule 2241, the “Proposed Rules”) in the Consolidated FINRA Rulebook.

SIFMA supports FINRA’s efforts to create a comprehensive and consolidated approach to the registration of research analysts and the management of potential conflicts of interest related to both equity and debt research. Without detracting from the support stated herein, SIFMA submits comments on the Proposed Rules to highlight various issues that

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit www.sifma.org.

² See Notice of Filing of a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook, Securities Exchange Act Release No. 73622 (Nov. 18, 2014), 79 Fed. Reg. 69939 (Nov. 24, 2014) (“FINRA Rule 2241 Proposing Release”) (available at <http://www.finra.org/Industry/Regulation/RuleFilings/2014/P601674>) [last visited Dec. 10, 2014]; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports), Securities Exchange Act Release No. 73623 (Nov. 18, 2014), 79 Fed. Reg. 69905 (Nov. 24, 2014) (“FINRA Rule 2242 Proposing Release”) (available at <http://www.finra.org/Industry/Regulation/RuleFilings/2014/P601677>) [last visited Dec. 10, 2014].

SIFMA believes require further consideration to ensure effective and efficient implementation by our member firms.

I. EXECUTIVE SUMMARY

SIFMA historically has supported rules that will help ensure that investors receive objective research. Rules designed to further that objective, however, should not unduly restrict the flow of information to investors or impose unnecessary burdens on members.

As a general matter, SIFMA supports the Proposed Rules. While SIFMA commends FINRA's efforts to produce a consolidated set of research rules, and SIFMA appreciates FINRA's willingness to amend its prior versions of the Proposed Rules to address some of our prior comments, SIFMA continues to have concerns about certain aspects of the Proposed Rules. We discuss these provisions and the modifications below.

II. GENERAL COMMENTS

A. SIFMA Appreciates the Principles Based Approach; Requests Clarity

FINRA is proposing to replace the prescriptive restrictions in the current rule with a broad, principles-based requirement to establish, maintain and enforce policies and procedures reasonably designed to identify and manage conflicts of interest and promote objective research. The Proposed Rules, however, also set forth minimum requirements for those written policies and procedures. The mix of a principles-based approach with prescriptive requirements in FINRA's Proposed Rules makes the Proposed Rules confusing and presents implementation and compliance challenges.

The Releases, for example, establish "minimum" requirements in several places, while noting that policies and procedures be reasonably designed. We appreciate FINRA's approach in allowing for flexibility to manage identified conflicts, and appreciate specific requirements in the form of prohibitions and restrictions where disclosure does not suffice. The Releases, however, go beyond listing specific requirements to impose minimum requirements alongside a principles-based approach in a manner that will make it difficult to implement. For example, the release for Proposed Rule 2241 notes that, "[t]he required policies and procedures must, *at a minimum*, be *reasonably designed* to *prohibit* republication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons..."³ (emphasis added). The use of "reasonably designed" is consistent with the flexible approach of the Proposed Rules; however, the use of "at a minimum" and "prohibit" seem superfluous and, if not, confusing. SIFMA recommends that the term "at a minimum" be deleted.

SIFMA appreciates FINRA's commitment to provide guidance on the application of the principles based standards. SIFMA encourages FINRA to maintain an ongoing dialogue

³ See FINRA Rule 2241 Proposing Release, 79 Fed. Reg. at 69942.

with SIFMA regarding the Proposed Rules, particularly during the implementation period. SIFMA anticipates the need for “frequently asked questions” or other forms of guidance. SIFMA welcomes the opportunity to work with FINRA on the appropriate guidance to ensure successful implementation and compliance.

B. FINRA Should Remove the Concept “Reliable” Research

SIFMA supports efforts to ensure investors receive independent research. The Proposed Rules, however, use the concept of “reliable” in several parts, such as the requirement that “*reliable* research that reflects the truly held opinions of research analysts...”⁴ or that “purported facts in its research reports are based on *reliable* information,”⁵ or that “[a] member may not distribute third-party research if it knows or has reason to know such research is not objective or *reliable*.”⁶ (emphasis added).

SIFMA believes that the Proposed Rules adequately capture and promote the goal of providing independent research to investors without the use of the term “reliable.” The use of the term “reliable” injects confusion regarding the requirements of the Proposed Rules and may inappropriately connote “accuracy” in the context of a research analyst’s opinions. SIFMA requests that the language be altered to remove the word “reliable.” If FINRA believes that the term is additive, that is, that “research that reflects the truly held opinions...” is different than “reliable research that reflects the truly held opinions...,” then FINRA should adequately explain that requirement. Otherwise, implementation and compliance will prove extremely difficult. We believe that Sarbanes Oxley’s use of the term “reliable” in a more general sense is inappropriate in the context of this rule and the concept is already captured by specific provisions in the rule.

C. Information Barriers: the Concept of “Review” is Already Captured Elsewhere

The Proposed Rules require “information barriers or other institutional safeguards to ensure that research analysts are insulated from the *review*, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision...”⁷ (emphasis added). The Proposed Rules already specifically address the “review” of research analysts in various contexts.⁸ FINRA, therefore, should delete the term “review” from the requirements for information barriers in the Proposed Rules. If FINRA is interpreting “review” differently, FINRA should clarify what is within the scope of the term “review” in this context, and how that differs, if at all, from those requirements mentioned above.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 69948.

⁷ *Id.* at 69911.

⁸ *See* Proposed Rule 2241(b)(2)(b)-(f) (restricting evaluation, and compensation determinations related to research analysts).

D. Customer Feedback Obtained by Debt Traders that Facilitate Customer Transactions on a Principal Basis

Proposed Rule 2242 requires that the compensation of a research analyst who is primarily responsible for preparation of the substance of a research report be reviewed and approved at least annually by a committee that reports to a firm's board of directors, or if the member has no board of directors, a senior executive officer of the firm. When reviewing a debt research analyst's compensation, Proposed Rule 2242 permits consideration of certain enumerated factors, including allowing "[s]ales and trading personnel, *but not personnel engaged in principal trading activities*, to provide input to debt research management into the evaluation of the debt research analyst in order to convey customer feedback."⁹ (emphasis added).

The debt market (unlike the equity market) is primarily a principal trading market and most debt traders are engaged primarily in facilitating customer transactions on a principal basis. In doing so, debt traders often interact directly with customers and obtain valuable feedback from the customers about the performance of a debt research analyst. Due to the nature of the debt market, debt traders may often have the most meaningful contact with a customer because customers do not always involve sales personnel when executing a trade. If firms are prohibited from using customer feedback obtained by debt traders that facilitate customer transactions on a principal basis, the firm's ability to gather information from clients will be severely compromised because debt traders are an important channel for customer feedback. While there are analyst rankings for debt analysts, they are not as robust or comprehensive as those available for equity analysts.

Accordingly, SIFMA believes that Proposed Rule 2242 should not prohibit debt traders engaged primarily in facilitating customer transactions on a principal basis from providing research management with customer feedback on a debt research analyst's performance.

E. FINRA Should Clarify References to Principal Trading

SIFMA remains concerned about the use of the term "principal trading" and potential confusion around FINRA's intent. SIFMA believes that references to sales and trading already by nature include all related agency, principal and proprietary trading activities. If references to "principal trading" are to clarify the full boundaries of the sales and trading activities then SIFMA suggests that FINRA change the language to refer to "sales and trading, inclusive of principal trading activities". If FINRA is making another distinction then SIFMA requests further clarification.

⁹ Proposed Rule 2242(b)(2)(G).

F. FINRA Should Retain Current Exceptions Related to Quiet Periods

NASD Rule 2711(f) contains an exception that permits publication and distribution of research or a public appearance concerning the effects of “significant news or a significant event on the subject company” during the quiet period and permits the publication or distribution of research pursuant to SEC Rule 139. SIFMA requests that the Proposed Rules retain the current exception. Specifically, SIFMA requests that the following language be included in the Proposed Rules:

“This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company or to a public appearance concerning such a subject company.”¹⁰

G. FINRA Should Amend the Scope of Supplementary Material Related to the Obligations of Associated Persons

The Proposed Rules provide that persons associated with a member must comply with such member’s policies and procedures as established pursuant to the Proposed Rules. With respect to Proposed Rule 2241, Supplementary Material .09 clarifies the obligations of each associated person under those provisions of the Proposed Rules that require a member to restrict or prohibit certain conduct by establishing, maintaining and enforcing particular written policies and procedures.¹¹ Similarly, Supplementary Material .08 clarifies that it would be a violation of Proposed Rule 2242 for an associated person to engage in the restricted or prohibited conduct addressed through policies and procedures.¹² Thus, under the Proposed Rules as currently drafted, the failure of an associated person to comply with such policies and procedures constitutes a violation of the Proposed Rules themselves.

SIFMA requests that FINRA limit the unprecedented scope announced in Supplementary Material .09 of Proposed Rule 2241, and Supplementary Material .08 of Proposed Rule 2242 to account for policies and procedures that go beyond the requirements of the Proposed Rules. In some cases, firms may establish policies and procedures that go well beyond the requirements of the Proposed Rules. In those cases, an associated person may violate aspects of internal policies and procedures that go beyond the requirements of the Proposed Rules, but the associated person would not, without more, have violated the Proposed Rules. As written the Supplementary Material may have the unintended

¹⁰ See NASD Rule 2711(f)(4).

¹¹ See FINRA Rule 2241 Proposing Release, 79 Fed. Reg. at 69950.

¹² See FINRA Rule 2242 Proposing Release, 79 Fed. Reg. at 69917.

consequence of discouraging firms from creating standards that extend beyond the requirements of the Proposed Rules.

H. FINRA Should Not Specifically Require Disclosure of Significant Financial Interest in the Debt of a Subject Company

Proposed Rule 2241 requires that members disclose if they or their affiliates maintain a significant financial interest in the debt of the subject company. Consistent with the requirements in Proposed Rule 2242, SIFMA requests that such a requirement with respect to debt of a subject company be deleted. Per the reasoning in Proposed Rule 2242, financial interests in the debt securities of a subject company in an equity research report regarding the subject company is an unnecessary and burdensome requirement. First, the catch-all provision already requires disclosure of material conflicts of interest. Thus, to the extent that a member's ownership interest in a debt security may present a conflict of interest, such disclosure already is required. Moreover, as noted in the context of Proposed Rule 2242, this disclosure will require a significant amount of time and resources to implement because members may need to establish new methods to determine ownership thresholds and analyze and compile lists of instruments that qualify for inclusion in such calculations.

I. "Institutional Investor" Concept Should be Based on FINRA Rule 2111

Proposed Rule 2242 exempts debt research distributed solely to eligible institutional investors from certain provisions, such as those regarding supervision, coverage determinations, budget and compensation. SIFMA previously expressed concerns with the proposed exemption for institutional investors.¹³ For example, in commenting on the difficulties related to Qualified Institutional Investor Certifications ("QIB Certifications"), SIFMA noted the different purposes of FINRA Rule 2111 and SEC Rule 144A.¹⁴ Mapping QIB Certifications to Suitability Certifications (or equivalent documentation) would be an extensive and costly exercise for member firms. In some cases, compliance may not be possible: for example, consider off-shore accounts involving foreign institutions that are not required to, and in fact do not, submit QIB Certifications. SIFMA, therefore, continues to believe that the application of the standard will be very difficult to implement and would actually disadvantage institutional clients who have represented that they are capable of, and are in fact, making independent investment decisions, and should therefore be capable of analyzing institutional debt research. SIFMA requests that the institutional investor concept in Proposed Rule 2242 be based on FINRA Rule 2111, recognizing that clients who have affirmatively indicated that they are capable of, and are in fact, exercising independent judgment with respect to recommended securities transactions also are capable of evaluating institutional debt research.

¹³ See letter from Kevin A. Zambrowicz, Managing Director, Associate General Counsel, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated Jan. 4, 2013 (*available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p197631.pdf>) [last visited Dec. 12, 2014].

¹⁴ *Id.*

J. SIFMA Requests a Reasonable Implementation Period

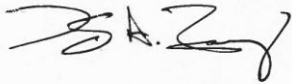
SIFMA requests that firms be provided with sufficient time to implement the Proposed Rules, including time to update policies and procedures and enhance systems and processes to comply with the Proposed Rules. FINRA's comprehensive and consolidated approach to the registration of research analysts and the management of potential conflicts of interest related to both equity and debt research will be difficult to implement. The implementation of many of the provisions in the Proposed Rules will require firms not only to draft or revise policies and procedures, but also to enhance their systems and processes. While SIFMA acknowledges ongoing discussions on these issues, given the breadth of both Proposed Rules, this will be a resource intensive and time consuming venture.

SIFMA estimates that firms will need at least 12 months after SEC approval. In many cases, the same personnel will be involved in implementing both Proposed Rules. Thus, SIFMA also requests that FINRA provide for the sequencing of the compliance dates of the Proposed Rules – requiring implementation with Proposed Rule 2241 first and then implementation of Proposed Rule 2242.

III. CONCLUSION

SIFMA appreciates the opportunity to comment on the Proposed Rules. SIFMA reiterates its support for many of the proposed provisions as well as its concerns with respect to others. SIFMA would be pleased to discuss any of these points further, and to provide additional information you believe would be helpful. If you have any questions or require further information, please contact Sean Davy at (212) 313-1118 (sdavy@sifma.org) or Kevin Zambrowicz at (202) 962-7386 (kzambrowicz@sifma.org).

Very truly yours,



Kevin Zambrowicz
Associate General Counsel
& Managing Director



Sean Davy
Managing Director

cc: Robert Colby, Chief Legal Officer, FINRA
Patrice Gliniecki, Senior Vice President and Deputy General Counsel, FINRA
Philip Shaikun, Vice President and Associate General Counsel, FINRA
Marlon Paz, Locke Lord