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Invested in America

April 2, 2012

Exclusively via e-mail to pubcom@finra.org

Ms. Marcia E. Asquith
Office of Corporate Secretary
FINRA
1735 K Street, N.W.
Washington, D.C. 20006-1506

Re: **Comments Regarding FINRA's Proposed Rules to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports (FINRA Regulatory Notice 12-09)**

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is submitting this letter to the Financial Industry Regulatory Authority, Inc. ("FINRA") in response to FINRA's request for comments regarding a proposal to apply objectivity standards and disclosure requirements to the publication and distribution of debt research reports, as set forth in FINRA Regulatory Notice 12-09 and the accompanying proposed rule text (the "Proposed Rule"). SIFMA welcomes the opportunity to respond to FINRA's Proposed Rule.

I. Introduction

As an initial matter, SIFMA appreciates FINRA's extensive efforts to obtain input from both sell-side and buy-side firms regarding debt research and the role that debt research analysts play in the fixed income markets. SIFMA also appreciates FINRA's issuance of a concept proposal in advance of the Proposed Rule, in order to solicit comments from market participants. Many of the revisions to the concept proposal, which appear in the Proposed Rule, appear to be carefully tailored to take into consideration the key differences between the debt and equity markets and the nature of debt research.

SIFMA, however, continues to have concerns about certain aspects of the Proposed Rule. In particular, we believe that the following areas should be modified or clarified:

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[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, visit www.sifma.org.

- Definition of "Debt Security": The definition of "debt security," which does not exclude investment grade sovereign securities (other than U.S. Treasury securities), agency securities, or derivatives;

- Definition of "Research Report": The definition of "research report," which is not fully aligned with the definition of "research report" in Regulation AC, and could capture many routine sales and trading communications;

- Prohibitions on Pre-publication Review: The prohibition on any review of debt research reports by certain non-research personnel for factual verification or other legitimate purposes, which goes beyond the restrictions for equity research in NASD Rule 2711;

- Research Budget Considerations: The prohibition on considering specific revenues or results derived from investment banking or principal trading activities in making research budget decisions;

- Analyst Compensation and Evaluation Considerations: The prohibition on the consideration of any contributions to principal trading activities in making compensation decisions, and any input into analyst evaluations by principal trading personnel;

- Content and Disclosure Requirements: Certain broadly-worded provisions in the content and disclosure requirements;

- Institutional Research: An affirmative, written "opt-out" requirement in order to rely on the institutional research framework; and

- Third-Party Research: Certain provisions relating to third-party research, which are not consistent with the third-party research provisions in NASD Rule 2711.

We believe that these proposed modifications and clarifications, which are discussed more fully below, are critical to preserve necessary interactions between research and non-research personnel and to permit research management to make well-informed decisions regarding firms' and customers' research needs. Given the many safeguards built into the Proposed Rule, we believe these changes would not diminish the important goals of investor protection and integrity of research, which the Proposed Rule is designed to achieve. SIFMA's comments are organized to respond to the order of issues in the Proposed Rule, and do not necessarily reflect their order of importance.

II. **Definitions**

A. **"Debt Security"**

The Proposed Rule would apply to any person who prepares a research report on a "debt security." The Proposed Rule defines the term "debt security" as any "security" except for any "equity security," "municipal security," "security-based swap," and "U.S. Treasury Security."

While SIFMA appreciates FINRA's exclusion for U.S. Treasury securities, we believe that investment grade government securities should be excluded from the definition of "debt security."[2] Like U.S. government securities, these securities are obligations of major nations or their agencies and instrumentalities. Also, like research on U.S. government securities, research on non-U.S. sovereign securities is more macroeconomic in nature and less likely to raise the potential conflicts that the Proposed Rule is designed to address. Markets for investment grade sovereign securities are deep and liquid, and the publication of research analyst views is unlikely to affect those markets in any meaningful way. Further, like U.S. government securities, many investment grade sovereign securities are traded and analyzed by investors as rate products rather than as debt instruments. Based on these considerations, we request that FINRA exclude non-U.S. investment grade government bonds from the definition of "debt security."

Additionally, SIFMA requests that U.S. government agency debt and agency mortgage-backed securities (collectively, "Agency securities") should be excluded from the definition of "debt security." Agency securities are traded and analyzed by investors as rate products rather than as debt instruments. Accordingly, the type of analysis and considerations that generally apply to corporate debt instruments (primarily the creditworthiness of the issuer) do not apply to Agency securities. The main drivers for the price of Agency securities are movement in interest rates (as represented by Treasuries or interest rate swaps) and, in the case of mortgage-backed securities, the rate of prepayment of the underlying loans. Agency securities present a high degree of fungibility with U.S. Treasury securities (especially at the shorter-dated end of the curve, where they may trade nearly flat to U.S. Treasury securities). Further, the depth of this market, similar to that of U.S. Treasury securities, is such that no single analyst's views are likely to affect such market in a meaningful way. For these reasons, SIFMA requests that FINRA also exclude Agency securities from the definition of "debt security."

Finally, SIFMA asks that FINRA clarify that "derivatives," as defined in the research conflicts of interest rules of the Commodity Futures Trading Commission ("CFTC"), are excluded from FINRA's definition of a "debt security."[3] We assume that it was not FINRA's intent to include derivatives that would be regulated by the CFTC's research rules and we believe that such a carve out is appropriate because these reports would be subject to, and governed by, a federal scheme of regulation.

B. **"Debt Research Report"**

The Proposed Rule defines a "debt research report" as "any written (including electronic) communication that includes an analysis of debt securities and that provides information reasonably sufficient upon which to base an investment decision."[4] This definition excludes the communications excepted from the definition of "research report" in NASD Rule 2711(a)(9). While we endorse FINRA's application of the Rule 2711(a)(9) exceptions to debt research, we

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[2] As a standard for determining which securities are investment grade, SIFMA proposes one derived from Exchange Act Rule 15c3-1(c)(2)(vi)(F)(1), which would include debt securities rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations. Should the SEC eventually develop an alternative to this benchmark, FINRA could adjust this standard accordingly.

[3] *See* 17 C.F.R. §§ 1.71(a)(4), 23.605(a)(4).

[4] Subsection (a)(3) of the Proposed Rule.

ask that FINRA provide certain additional exclusions and conform the definition of "research report" in the Proposed Rule to the SEC's definition in Regulation AC.

We assume that FINRA intended the definition of "research report" in the Proposed Rule to be consistent with the definition of "research report" in Rule 500 of Regulation AC, which defines a "research report" as a "written communication (including an electronic communication) that includes an analysis of *a security or an issuer*" (emphasis added). Accordingly, we ask that FINRA revise the definition of "research report" in the Proposed Rule to focus on an analysis of "a security or an issuer," as opposed to "an analysis of debt securities" (which, if interpreted broadly, could cover an analysis of a class of debt securities that does not analyze an individual security or issuer). In addition, we ask that FINRA adopt all of the general exclusions from the definition of "research report" that were endorsed by the SEC, in particular the exclusion for "reports commenting on or analyzing particular types of debt securities or characteristics of debt securities" that do not include an analysis of, or recommend or rate, individual securities or companies.[5] We ask FINRA to include this exclusion in the rule text or, alternatively, in the discussion of the rule, to ensure consistency with the Proposed Rule and Regulation AC.

In addition, we believe it is important to provide limited exclusions for certain communications by sales and trading personnel that are common in the debt markets, particularly where those communications are sent only to institutional investors. While we fully understand FINRA's resistance to providing an across-the-board exemption for trader commentary based on the department of origin, we feel strongly that narrower exceptions, which are more specifically tailored to the debt markets, are necessary in order to meet the needs of both market participants and investors, who value information provided by non-research personnel. For example, an e-mail sent from the sales and trading desk to fifteen or more institutional clients highlighting a particular bond and providing a reasonable basis for a trading decision should not, in our view, amount to a debt research report. While SIFMA appreciates the tiered approach for institutional debt research, the current proposed structure does not provide the relief we that believe was intended because certain institutional-only material produced by non-research personnel may, nevertheless, be deemed "research" depending on their content, and therefore would be subject to the restrictions that apply to institutional research. Accordingly, we encourage FINRA to consider additional exclusions, which should be tailored so as not to create a "loophole" through which "biased and non-transparent research could be disseminated to *retail investors*."[6]

III. **Prohibition on Prepublication Review of Debt Research Reports by Certain Non-Research Personnel**

Subsection (b)(2) of the Proposed Rule would require firms to adopt policies and procedures that prohibit pre-publication review, clearance, or approval of debt research reports by persons involved in sales and trading, principal trading, or investment banking. While SIFMA agrees that there should be restrictions and controls around the review of research by non-research personnel, a flat prohibition on such review by these personnel goes beyond the

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5 *See Regulation Analyst Certification*, 68 Fed. Reg. 9482, 9485 (Feb. 27, 2003).

6 Regulatory Notice 12-09, at p. 4 (emphasis added).

well-established and balanced framework in NASD Rule 2711 for permitting non-research personnel to review research reports. For this reason, SIFMA asks that FINRA revise subsection (b)(2) so that it is consistent with the provisions regarding prepublication review of research reports in NASD Rule 2711.

In this regard, non-research personnel such as sales, trading, and investment banking can often perform an important role in reviewing research reports for factual verification. For example, for research on new complex structured products, analysts often need to interact with sales and trading desks, or origination or banking personnel, to verify that the basic facts about the products are correct. More generally, analysts rely on the expertise of sales and trading personnel to corroborate that their statements are accurate where research references market and trading activity, prevailing market prices, or yields. As long as there are controls and safeguards in place to monitor such reviews for potential conflicts or inappropriate input (similar to those in NASD Rule 2711), SIFMA does not believe that there is any reasonable justification for prohibiting this review, and the benefits of such reviews clearly outweigh the risks if such restrictions and controls are adopted.[7]

IV. Prohibition on Considering Specific Revenues or Results in Making Budget Decisions

Subsection (b)(3)(B) of the Proposed Rule would prohibit senior management from considering specific revenues or results derived from investment banking services or principal trading activities in determining the research budget. While SIFMA agrees that research budget decisions should be made by senior management, we also believe it would not be feasible for senior management to make accurate and appropriate research budget decisions if they were unable to consider trading and investment banking revenues in doing so. For these reasons, SIFMA urges FINRA to permit the consideration of principal trading and other business revenues in making budget decisions.

Fixed income research is not self-funded. It relies on funding from other areas of the firm to operate, and particularly on funding from sales and trading departments. During the budgeting process, senior management must assess requests regarding the hiring of new analysts and the allocation of research resources across a variety of markets and disciplines. Allowing non-research personnel to articulate the demand for debt research, including product trends and customer interests, but not permitting senior management to validate those demands on the basis of historical or prospective revenues, will inevitably result in a mismatch between research

[7] *See* NASD Rule 2711(b)(3). Under Rule 2711, non-research personnel may review a research report before publication to verify factual information or identify conflicts of interest, provided that written communications between research and non-research personnel about the research report are made through legal or compliance personnel (or copied to them), and that any oral communication between research and non-research personnel about a research report is documented and made either through or in the presence of legal or compliance personnel.

department funding and actual customer needs.[8] The allocation of resources to specific sectors or areas (*e.g.*, for asset-backed research or high-yield research) is necessarily, and should continue to be, aligned with the importance of those areas to a firm's franchise and its sales, trading, and investing customers. The relative importance of one area over another (*e.g.*, asset-backed v. high-yield research) can only be measured by the revenues attributed to those areas that are generated by the firm's various business lines (*e.g.*, asset-backed v. high yield sales, trading, and banking revenues). For example, if revenue from banking, sales, and trading is down, or expected to be down, 20% for mortgage-backed securities, but up 10% for high-yield corporate bonds, senior management should be permitted to consider all of these revenue lines in determining whether additional resources are needed to cover high-yield research.

Finally, SIFMA believes that allowing consideration by a firm's senior management of all business revenues in setting the research budget would not undermine the integrity of research. There are many safeguards in the Proposed Rule designed to ensure that decisions regarding the allocation of research resources are insulated from inappropriate pressure from either investment banking or principal trading, including: (i) the requirement that budget decisions be made by senior management, which may not include investment banking or principal trading personnel; and (ii) the proposal that prohibits analysts' compensation from being tied to specific trading or investment banking transactions. Given these safeguards, it is not clear what benefit would be served or what harm would be cured by further prohibiting senior management's consideration of all revenue streams. SIFMA therefore asks FINRA to permit the consideration of principal trading and other business revenues in making budget decisions.[9]

V. **Prohibitions Related to Analysts' Compensation and Evaluations**

Subsection (b)(3)(C) of the Proposed Rule would prohibit compensation based upon specific investment banking services, specific trading transactions, or contributions to a member's investment banking services or principal trading activities. Also, under subsection (b)(3)(D), sales and trading personnel (but not personnel engaged in principal trading activities) may provide input into the evaluation of debt research analysts in order to convey customer feedback, provided that final compensation determinations are made by research management.

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[8] Similar restrictions on input into budget by investment banking personnel have not worked well under the terms of the Global Research Settlement. *See* relevant orders in *SEC v. Bear, Stearns & Co., Inc.*, 03 Civ. 2937 (WHP) (S.D.N.Y.); *SEC v. Lehman Brothers Inc.*, 03 Civ. 2940 (WHP) (S.D.N.Y.); *SEC v. U.S. Bancorp Piper Jaffray Inc.*, 03 Civ. 2942 (WHP) (S.D.N.Y.); *SEC v. UBS Securities LLC*, 03 Civ. 2943 (WHP) (S.D.N.Y.); *SEC v. Goldman, Sachs Co.*, 03 Civ. 2944 (WHP) (S.D.N.Y.); *SEC v. Citigroup Global Markets Inc.*, 03 Civ. 2945 (WHP) (S.D.N.Y.); *SEC v. Credit Suisse First Boston LLC*, 03 Civ. 2946 (WHP) (S.D.N.Y.); *SEC v. Morgan Stanley*, 03 Civ. 2948 (WHP) (S.D.N.Y.); *SEC v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 03 Civ. 2941 (WHP) (S.D.N.Y.); *SEC v. Deutsche Bank Securities Inc.*, 04 Civ. 6909 (WHP) (S.D.N.Y.); *SEC v. Thomas Weisel Partners LLC*, 04 Civ. 6910 (WHP) (S.D.N.Y.) (collectively, the "Global Research Settlement"). These rules have led to immense difficulty in making budget and hiring determinations, and have produced frequent mismatches between the research department capabilities and the needs of the firm and firm customers who participate in offerings. SIFMA hopes that similar outcomes can be avoided under FINRA's rules for debt research.

[9] Although we acknowledge that the Proposed Rule would permit sales revenue to be considered in making budget decisions, as a practical matter, because clients pay firms when transacting trades and not when talking to sales, it may not be feasible to separate sales revenue from trading revenue.

SIFMA agrees that final compensation determinations should be made by research management, based on specific factors, as applicable. SIFMA also agrees that there should not be formulaic connections between analysts' compensation and profits and losses on specific investment banking and sales and trading deals and transactions. However, the broad prohibitions on considering (i) the input of principal trading personnel, and (ii) *any* contributions to a member's principal trading activities go beyond the balanced and well-established provisions in NASD Rule 2711. They do not recognize that principal traders are a key source of contact with customers, and often may be the principal contact that a customer has with the firm. Nor do they take into account that many fixed income personnel may wear multiple "hats" (*e.g.*, a single person may be responsible for trading for a firm's account and engaging in sales activities). Because the vast majority of debt trading is conducted on a principal basis, by necessity and by function of the market, these prohibitions do not acknowledge the important role that debt analysts play in acting as a resource to desks that are serving critical functions in providing liquidity to the market and facilitating customer orders (*e.g.*, market making and customer facilitation trading desks). For these reasons, and as described more fully below, SIFMA urges FINRA to modify these prohibitions and adopt a standard that permits research management and the compensation committee to consider analysts' contributions to principal trading activities and solicit the views of principal trading personnel on analyst compensation and evaluations, provided that research management and the compensation committee maintains exclusive authority over final decisions. If there is a concern about particular types of feedback, we encourage FINRA to restrict or prohibit that feedback, and not the persons providing it. However, if FINRA disagrees, SIFMA asks that the restriction on input from principal trading extend only to those principal trading activities that have no client or customer-facing responsibilities.

Principal trader input into analyst compensation and evaluations is critical because, in the fixed income markets, principal trading personnel regularly interface with customers and therefore are a necessary resource for providing customer feedback on the quality and productivity of debt research analysts. This input is particularly important because certain benchmarks that may be used to determine compensation in the equity research context are inapposite or not present in the fixed income context. For example, unlike with equity research, fixed income analysts do not have "price targets" for their bonds, and may not have estimates for companies they cover, so there are fewer objective bases to measure the accuracy of their research. Additionally, because fixed income research coverage is periodic and analysts cover thousands of bonds (unlike equity research), it is impossible for research management to determine the "quality of an analyst's research" without obtaining input from all constituencies with whom the analyst interacts—including principal trading personnel. Also, there is no mechanism for retail customers to provide comprehensive views on research, and there is limited ability for institutional customers to provide formalized feedback regarding the quality of any research product. In this regard, there are only a small number of surveys and broker votes relevant to fixed income research.[10] For these reasons, principal trading and other non-research personnel play a critical role in passing customer feedback along to research management. To

[10] Even for equity research, the amount of detailed information contained in broker votes varies widely among customers, with many providing limited feedback and others providing no broker votes at all. So, by necessity, broker vote information is only one element considered when assessing the customer impact of equity analysts.

this point, it is worth noting that in its recently-adopted research analyst conflicts of interest rules, the CFTC recognized the legitimacy of this role, and adopted a provision that allows customer indicators of analyst performance to be passed to research management by all trading and other business personnel, provided that research management is responsible for final decisions.[11]

It is also important for analysts' contributions to principal trading activities to be considered by research management and compensation committees. Research analysts' ability to offer articulate and insightful analysis to trading desks is a significant part of their roles at firms. To this end, traders rely heavily on debt research and research analysts to help them better understand the terms of and risk factors associated with specific bonds, so that they are better able to assist customers in making informed investment and trading decisions. Traders and trading management also rely on research analysts to help them manage risk related to firm positions, and to facilitate customer trades through market making and counterparty transactions. The nature of the debt markets requires firms to act in a principal capacity to facilitate customers' trading. Firms with significant debt franchises are required to carry on their books debt securities or instruments representing many issuers and classes of securities in order to facilitate ordinary customer trading flows. To assist them in better managing risk and firm positions and facilitating customer transactions, traders will often talk to research analysts to more fully understand an issuer's debt capital structure and how macroeconomic and market factors may affect the issuer's different classes of bonds. For these reasons, debt analysts spend a considerable amount of time interacting with trading personnel. It would not be fair if research management could not take this time and effort into account in making compensation and evaluation decisions.

Putting aside these legitimate reasons for allowing research management to consider contributions to principal trading activities and allowing the input of principal trading personnel, SIFMA does not see any discernible investor protection benefit in prohibiting such consideration or input. To this end, there are important safeguards that FINRA has proposed for retail research that would promote research analyst independence and quality with respect to compensation considerations. These safeguards, which SIFMA fully supports, include the following: (i) research management shall be responsible for final decisions regarding evaluations and compensation; (ii) debt research analysts shall not be compensated based on the success of or revenues derived from specific sales and trading transactions; and (iii) research analysts' compensation shall be reviewed and approved by a compensation committee, which will consider the quality of the research product, and will serve as an important bulwark against inappropriate influence of sales and trading personnel into compensation decisions. These

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[11] *See* 17 C.F.R. §§ 1.71(c)(3), 23.605(c)(3). As originally proposed, the CFTC's rule would not have permitted such input. Based on concerns raised by SIFMA and other commenters, the CFTC modified its proposed rules to permit personnel of business trading units and clearing units to "communicat[e] client or customer feedback, ratings and other indicators of research analyst performance to research department management." *See Swap Dealer and Major Swap Participant Recordkeeping and Reporting, Duties, and Conflicts of Interest Policies and Procedures; Futures Commission Merchant and Introducing Broker Conflicts of Interest Policies and Procedures; Swap Dealer, Major Swap Participant, and Futures Commission Merchant Chief Compliance Officer*, at pp. 97-99, *available at* http://cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister022312b.pdf (not yet published in the Federal Register as of the date of this letter).

important safeguards have worked well in the equity context, and will help assure that decisions relating to debt research are not inappropriately influenced by other areas of the firm.

SIFMA is not aware of instances or examples that would justify a complete prohibition on research management's consideration of analysts' contributions to the firm's principal trading activities or the input of principal trading personnel. For the reasons set forth above, we believe that any measurable investor protection benefit derived from these prohibitions would be greatly outweighed by the costs of prohibiting important constituencies from providing feedback regarding research.

VI. Content and Disclosure in Debt Research Reports

A. "All Conflicts"

Subsection (c)(5) of the Proposed Rule requires members to disclose in any debt research report "*all conflicts* that reasonably could be expected to influence the objectivity of the debt research report and that are known or should have been known by the member or debt research analysts on the date of publication or distribution of the report" (emphasis added).[12]

This "all conflicts" standard is not present in NASD Rule 2711, and could be interpreted very broadly. Read literally, this language would require members to engage in a sweeping exercise to identify—with respect to every research report—*all* possible conflicts (material or immaterial) that may be known to anyone at the member. Compliance with such a standard is simply not possible. The proposed language also assumes that conflicts could be expected to and do influence the objectivity of research reports, even though FINRA's existing research analyst rules and Regulation AC assume the contrary, *i.e.*, that potential conflicts can be managed using disclosures and certifications in order to preserve the objectivity of research analysts and research reports. Further, it is not clear which types of conflicts this standard is intended to capture beyond those conflicts covered by subparagraph (c)(5)(H) (which requires disclosure of "any other material conflict of interest of the debt research analyst or member that the debt research analyst or an associated person of the member with the ability to influence the content of a debt research report knows or has reason to know at the time of publication or distribution of the report").

For these reasons, SIFMA asks FINRA to either (i) specify the types of conflicts that it intends to capture by this new provision, or (ii) maintain the standard in Rule 2711, which includes a known "actual, material" conflict standard, as opposed to an "all conflicts" standard.

B. "Or Distribution"

Subsection (c)(5)(H) applies the "catch all" material conflicts disclosure requirement to conflicts that are known (or where there is reason to know) at the time of publication *or distribution* of the research report.[13] In contrast, NASD Rule 2711(h)(1)(C) only applies at the

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[12] In this respect, the Proposed Rule is consistent with proposed FINRA Rule 2240(c)(5), which we noted is similarly problematic in our comment letter of November 14, 2008 ("2008 Comment Letter").

[13] The Proposed Rule is also consistent with proposed FINRA Rule 2240(c)(5) in this respect, which we believe is similarly problematic, as discussed in our 2008 Comment Letter.

time of "publication of the research report." This "or distribution" standard is a much broader standard and not reflective of the conflicts of interest that apply at the time the analyst writes the research report. This standard is also problematic because it could require members to delay the distribution of any research reports until they have surveyed any persons who have the "ability to influence the content of the research report" to determine whether such persons "know or have reason to know of any material conflicts."

Further, it is unclear how members could control and prevent the distribution of reports that already have been published, in order to determine whether additional disclosures are required. For example, if a member publishes a report, does it need to monitor and prevent any subsequent mailings of that report by its salespeople or other associated persons and, potentially, include additional disclosures in those reports? We do not believe such a requirement would be practical or useful to investors. Indeed, to the extent any potential conflicts of interest arise after the publication of a report, such conflicts would not have influenced the substance or content of the report. For these reasons, SIFMA asks FINRA to modify the Proposed Rule so that it is consistent with the language that is currently in NASD Rule 2711(h)(1)(C).

C. **Requests for Clarification and Consideration**

SIFMA requests clarification of or further guidance on the following disclosure provisions.

- Subsection (c)(2) provides that "any recommendation or rating . . . be accompanied by a clear explanation of the valuation method used and a fair presentation of the risks that may impede the achievement of the recommendation or rating." SIFMA asks FINRA to clarify that the "valuation method" requirement only applies if the analyst utilized a formal valuation method (because some recommendations may not involve a formal valuation method, although in such cases the recommendation would remain subject to the reasonable basis requirements).

- Subsection (c)(3)(A) states that a member employing a rating system must include in its debt research reports "the percentage of all securities rated by the member to which the member would assign a 'buy,' 'hold,' or 'sell' rating." SIFMA asks that the term "securities" in this provision be qualified as "debt securities."

- Subsection (c)(4) requires "rating tables" if a debt research report contains a rating for a debt security and the member has assigned a rating for that debt security for at least one year. SIFMA asks FINRA to grant firms the flexibility to make a good faith determination of the universe of relevant securities that constitute a debt security for purposes of these ratings tables, given that bonds of the same issuer can and often do have different ratings.

- SIFMA asks FINRA to provide guidance regarding the difference between a "recommendation" and "rating" for purposes of the proposed disclosures. For example, if a debt analyst recommends a relative value or paired trade idea (*e.g.*, "Buy security X, sell security Y"), we believe this statement should be treated as a recommendation, but

not as a rating on the individual securities (in the example, a "Buy" rating on X and a "Sell" rating on Y).

In addition, we ask that, in formulating the final disclosure provisions, FINRA consider providing firms with flexibility in making disclosures in debt research reports on sovereign issues. In this regard, tracking relationships with sovereign issuers will be challenging given the many and diverse relationships that firms may have, or seek to have, with governments. At the same time, the potential for inappropriate influence is significantly diminished for research on these issuers because research on non-U.S. sovereign securities is more macroeconomic in nature and, therefore, less likely to raise the potential conflicts that the Proposed Rule is designed to address. Further, the markets for many sovereign securities are deep and liquid, and the publication of research analyst views is unlikely to affect those markets in any meaningful way.

VII. Debt Research Reports Provided to Institutional Investors

A. Opt-out Provision

We appreciate FINRA's proposal of a tiered regulatory framework for research sent to retail and institutional investors. This framework is similar to the tiered framework currently in place under NASD Rules 2210 and 2211 for sales materials sent to retail and institutional investors. We also appreciate the important modifications that FINRA has made to the institutional research provisions, by focusing the prohibitions and restrictions on interactions between research and investment banking personnel. However, we are concerned that the requirement that member firms must obtain "affirmative written consent" from institutional investors in order to rely on the institutional research framework will be unduly burdensome and impractical to implement. We, therefore, urge FINRA to adopt the "opt-in" approach articulated in the concept proposal, *i.e.*, that fixed income research provided to institutional investors is exempted from many of the provisions applicable to research provided to retail investors, *except* where an institutional investor affirmatively opts in to the retail debt research framework in order to receive the more protective regime. In this regard, we believe that the additional costs and burdens of requiring eligible institutional investors to affirmatively choose the institutional debt research framework would exceed any benefit that an institutional investor would receive by being automatically included within the retail debt research framework (as under the Proposed Rule).

The proposed "opt-out" approach would be both burdensome and duplicative. It would be duplicative because firms already expend resources to obtain and document similar consents in connection with their suitability obligations and in identifying institutional investors' "Qualified Institutional Buyer" status for Rule 144A transactions. It also would be burdensome because firms would need to build additional systems and procedures to track clients who have not opted to receive institutional research. Specifically, firms would need to deploy new entitlement technology on their institutional research platforms, which does not exist for a similar purpose. This would involve the development and implementation of a mechanism to request, classify, and capture institutional client opt-out certifications, as well as the associated operations and relationship efforts required to explain the initiative and technology solution to clients. Firms would also need to develop logic and/or links between various institutional research reports and eligible institutional investors who have been deemed entitled to receive

such research. For instance, a mechanism would need to be created that would allow clients who have not opted out of the retail debt research framework to continue to receive research about U.S. Treasury securities, but would block them from receiving institutional corporate debt research.

While we acknowledge that there would be client tracking requirements under the "opt-in" framework articulated in FINRA's concept proposal (which we prefer), these requirements would be far less onerous than those that would be imposed by the "opt-out" approach in the Proposed Rule, which would require firms to track and obtain certifications for *all* institutional clients who receive institutional research. As compared to the approach in the concept proposal, the approach in the Proposed Rule is also problematic because it would greatly hinder firms' ability to produce and distribute institutional research. Under the Proposed Rule, firms presumably would be required to cease any and all publication of institutional research until they obtained the required certifications. This would not be the case under the framework articulated in the concept proposal, whereby firms could continue to publish institutional research, but could not disseminate such research to customers that opt in to the retail research framework.

In addition to the costs and burdens described above, the proposed opt-out approach could lead to confusion or conflict in the distribution of institutional debt research within particular institutional investors. Even if a research department could develop the appropriate systems to affirmatively confirm that each institutional investor has opted in to the institutional investor regime under the Proposed Rule, which would only address the distribution of research from research departments, there would still be a substantial risk of confusion for sales forces as to which level of research could be distributed within institutional clients. In this regard, debt research is frequently distributed to institutional investors based on asset class, and is permissioned at the level of particular individuals within in institutional investor; that is, certain people within an institutional investor have permission to receive certain research, and the permission is not granted to the institutional investor as a whole. Under the proposed framework, firms could be required to collect affirmative written consents to receive institutional debt research from each of these individuals. On top of the burdens imposed by such intake and collection, there could be conflicting responses from within a single institutional investor, thereby creating additional tracking difficulties in the distribution of research.

SIFMA appreciates that there are differences in sophistication within the class of institutional investors. However, these differences are better addressed by the existing suitability rules. Research is not in and of itself a solicitation to engage in a trade, and if research were sent to a client who was not sophisticated enough to trade the product discussed, that should be determined on the basis of the suitability rules at the time the client chooses to engage in a trade. Also, unlike suitability determinations, which can more easily be made on a client-by-client basis and can be linked to specific firm trading systems, research is distributed more broadly, on a global basis. As such, it would be incredibly difficult to track and process all recipients who have affirmatively consented to receive it. Additionally, the Proposed Rule's requirement that the affirmation be in writing is more burdensome than the suitability rules, which do not have a similar requirement.

Finally, we believe the opt-out framework in the Proposed Rule is not necessary to protect institutional investors, given the (i) coupling of the conflict of interest provisions for

institutional research in subsection (f)(2) with the required prominent disclosures, (ii) the ability of institutional investors to decline to receive institutional research, and (iii) the existing content standards in NASD IM 2210-1. Given these safeguards, we do not see any incremental benefit that the proposed opt-out regime would offer that would outweigh the costs of implementation. We believe that there is no need to broadly impose such costs, where the goal of affording elevated protections to institutional investors who desire them may be achieved with a more finely-tailored mechanism.

B. **Required Disclosure**

Under subsection (f)(3)(A), debt research reports provided only to eligible institutional investors must disclose on the first page that: "This research report is intended for institutional investors and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors." SIFMA requests that FINRA permit firms to modify this disclosure, instead, to state "This document is intended for institutional investors . . . ." Such a modification would be appropriate, for example, where material is not produced by research department personnel, but rather sales and trading personnel.

VIII. **Third-Party Research Reports**

The Proposed Rule's provisions for third-party research are not consistent with NASD Rule 2711(h)(13) (third-party research). We ask that FINRA make these provisions consistent with the current framework in NASD Rule 2711 or clarify the scope of what the provisions are intended to capture. For example, Proposed Rule subsection (h)(1) requires firms to "establish, maintain and enforce policies and procedures reasonably designed to ensure that any third-party debt research report it distributes is reliable *and objective*" (emphasis added). This requirement to ensure that third-party research is "objective" does not appear in NASD Rule 2711(h)(13), and it is not clear what FINRA means by "objective" in this context. Further, subsection (h)(2) requires firms to "disclose any material conflict that can reasonably be expected to have influenced the choice of a third-party debt research report provider or the subject company of a third-party debt research report." This provision also is not in NASD Rule 2711(h)(13), and it is not clear what types of conflicts this provision is intended to capture.

IX. **Broad Prohibitions on Interactions Between Research Analysts and Non-Research Personnel**

A. **Prohibitions on Interactions with Investment Banking Personnel**

1. Joint Due Diligence

Supplementary Material .02 prohibits joint due diligence (*e.g.*, confirming the adequacy of disclosures in offering or other disclosure documents for a transaction) conducted with a company in the presence of investment banking department personnel. This provision goes beyond the prohibitions in the equity research framework, as well as beyond the requirements of the amended Global Research Settlement, which allows joint due diligence under certain conditions. To be sure, the Global Research Settlement was recently amended in recognition of the fact that a broad prohibition on *any* joint due diligence creates unnecessary inefficiencies and additional costs for firms. We do not believe there is any benefit to be gained by prohibiting

debt research analysts from conducting joint due diligence with investment banking personnel, particularly if firms adopt policies and procedures to control any potential conflicts or pressures that may arise in the context of joint due diligence. Accordingly, we request that FINRA allow firms to permit analysts and investment banking personnel to jointly conduct due diligence, provided firms have such policies and procedures in place.

2. Requests for Clarification

Subsection (b)(2)(C)(i) of the Proposed Rule would require firms to prohibit analysts from "participating in pitches and other solicitations of investment banking services transactions." SIFMA asks FINRA to (i) provide guidance on what it intends to capture by this provision, or (ii) conform the prohibition to the more precise language in NASD Rule 2711, which prohibits analysts from "participating in pitches to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business." We ask that, at a minimum, FINRA clarify the types of contacts that this provision is not intended to capture.

Subsection (b)(2)(C)(ii) of the Proposed Rule would require firms to prohibit analysts from participating in "road shows and other marketing on behalf of issuers." SIFMA asks FINRA to clarify that, consistent with NASD Rule 2711, this prohibition is only intended to cover road shows and other marketing "related to an investment banking services transaction," and not non-deal road shows. Alternatively, if this is not the intention, we ask FINRA to clarify the types of activity that are intended to be covered, and that non-deal road shows are not included. We also ask FINRA to clarify that debt research analysts may passively attend company-sponsored road shows where the presence of the analysts is not announced to other participants. SIFMA believes such passive attendance does not raise the concerns the Proposed Rule is designed to prevent. Restrictions on the ability of debt analysts to hear information from company management are particularly problematic in debt offerings because debt offerings often move very quickly and there may be few opportunities for analysts to obtain information directly from company management during the truncated offering process. Such passive participation is also consistent with NASD Rule 2711.[14]

B. **Prohibitions on Interactions with Sales and Trading Personnel**

Supplementary Material .04(a)(1) contains a general prohibition on "attempting to influence a debt research analyst's opinions or views for the purpose of benefiting the trading position of the firm, a customer, or a class of customers." SIFMA asks FINRA to clarify that this prohibition will not capture ordinary-course communications with research analysts, and that it is meant to act as a prohibition on non-research direction over the decision to publish a research report and on non-research direction over the views and opinions expressed in debt research reports. We note that such a clarification seems to accord with the intent of the

[14] *See* NASD Notice to Members 07-04, p. 4.

proposed language, and would be consistent with the CFTC's recently-adopted conflicts of interest rules for research analysts.[15]

Supplementary Material .04(a)(2) contains a general statement that debt research analysts are prohibited from "identifying or recommending specific potential trading transactions to sales and trading or principal trading personnel that are inconsistent with such debt research analyst's currently published research reports." SIFMA asks that FINRA codify, in this supplementary material, the guidance in Regulatory Notices 11-11 and 12-09, which provides that in assessing whether a debt research analyst's permissible communications are "inconsistent" with the analyst's published research, a firm may consider the context, including that the investment objectives or time horizons being discussed differ from those underlying the analyst's published views.

X. **Effective Dates**

Finally, implementation of many of the provisions in the Proposed Rule will require firms to build new systems, data feeds, and processes and will be time consuming to implement. In particular, compliance with the new disclosure rules likely will require a lengthy period of time to be put into place. SIMFA, therefore, requests that FINRA take these factors into consideration, and solicit comments from the industry, in determining the effective dates for the various provisions of the Proposed Rule.

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We appreciate the opportunity to comment on the Proposed Rule. We reiterate our support for many of the proposed provisions as well as our concerns with respect to others. We would be pleased to discuss any of these points further, and to provide additional information you believe would be helpful. Please feel free to contact me, at (202) 962-7373, if you have any questions or comments.

Sincerely,

Ira D. Hammerman
Senior Managing Director, General Counsel and Secretary, SIFMA

cc: Mr. Marc Menchel, Executive Vice President and General Counsel for Regulation, FINRA
Mr. Philip Shaikun, Associate Vice President, Office of General Counsel, FINRA
Ms. Racquel Russell, Assistant General Counsel, Office of General Counsel, FINRA

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[15] The CFTC's rules provide that non-research personnel "shall not direct a research analyst's decision to publish a research report" and "shall not direct the views and opinions expressed in a research report." 17 C.F.R. §§ 1.71(c)(1)(i), 23.605(c)(1)(i).