INVESTMENT COMPANY INSTITUTE

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June 5, 2017

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: *Desk Commentary Safe Harbor (Regulatory Notice 17-16)*

Dear Ms. Mitchell:

The Investment Company Institute (ICI)[1] writes to support FINRA's proposal to create a safe harbor for desk commentary—written communications from a broker-dealer's sales and trading personnel that provide information about market conditions for a particular security, issuer, sector, or asset class.[2] A safe harbor is a practical way to ensure that regulated funds will continue to receive timely information about market conditions that they can use to facilitate long-term returns to fund shareholders. This letter explains the importance of desk commentary to regulated funds and describes how a workable safe harbor for desk commentary would ensure that regulated funds retain access to these informative communications.

I. Desk Commentary Provides Valuable Information to Regulated Funds

US households rely on regulated funds to save for their long-term financial goals, such as the purchase of a home, a child's education, or a secure retirement. American businesses and other institutional investors also rely on regulated funds to achieve a wide array of financial objectives. To help investors reach their savings goals, regulated funds invest in the financial markets, holding a

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[1] ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$19.6 trillion in the United States, serving more than 95 million US shareholders, and US$5.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] FINRA Regulatory Notice 17-16, Desk Commentary Safe Harbor (April 2017), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-16.pdf (Proposal).

sizeable share of the securities outstanding across a variety of asset classes.[3] Regulated funds rely on asset management firms—and specifically the portfolio managers and traders employed by asset management firms—to invest fund assets and implement the funds' investment objectives and strategies. In managing the portfolio of a regulated fund, a portfolio manager of an asset management firm determines which securities to buy or sell for the fund, in accordance with the objectives described in the fund's prospectus. Traders with the asset management firm (buy-side traders) seek to execute the transactions in the most efficient and cost effective manner to effectuate the investment strategy.

Desk commentary provides buy-side traders with timely information that allows them to strategically implement previously-made investment decisions. The information includes insights into market conditions in a particular security, general market sentiment, and views on specific sectors or asset classes. The providers of desk commentary—the sales and trading personnel of broker-dealers—frequently have unparalleled visibility into current market conditions because they execute trades in many securities on behalf of various firms with differing investment objectives. The real-time information that buy-side traders receive through desk commentary can enhance their ability to improve execution quality for the benefit of fund shareholders. Shareholders would lose these benefits if buy-side traders are not able to receive desk commentary.

II. A Practical Solution is Critical to Continue the Flow of Desk Commentary to Buy-Side Traders

The broad definition of the term "research report" in FINRA rules 2241 and 2242 raises at least a possibility that some desk commentary technically could be deemed research reports. We have concerns with that outcome. Rules 2241 and 2242 define "research report" and "debt research report," respectively, to include any written communication that contains an analysis of a security or issuer and that "provides information reasonably sufficient upon which to base an investment decision."[4] The Proposal acknowledges that many institutional investors "do not base their investment decisions" on desk commentary and, as described above, portfolio management and trading are distinct services that asset managers provide to regulated funds.

If, however, FINRA views desk commentary or certain desk commentary as potentially falling within the definition of the term "research report," broker-dealers would be put in the untenable position of facing extensive compliance obligations incompatible with providing timely desk commentary to asset management firms. Broker-dealers, for example, would be required to limit

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[3] *See* 2017 Investment Company Factbook at 12-13. The factbook is available online at https://www.ici.org/pdf/2017_factbook.pdf. As of the end of 2016, investment companies held approximately 31 percent of the shares of US-issued equities outstanding, 19 percent of bonds issued by US corporations and foreign bonds held by US residents. Investment companies also held 13 percent of the US Treasury and government agency securities and 23 percent of the municipal securities outstanding at the end of 2016.

[4] *See* FINRA rules 2241 (defining "research report") and 2242 (defining "debt research report").

interactions between authors of research reports and sales and trading personnel.[5] In the case of desk commentary, this means a member of a broker-dealer's sales and trading personnel, as a provider of desk commentary, must limit interactions with himself. This obviously is an absurd outcome. Similarly, FINRA's requirements concerning the content and disclosure provided in research reports require extensive review that could be difficult to complete before the relevant desk commentary becomes stale.[6] As a result, any regulatory determination that certain desk commentary rises to the level of research likely would cause broker-dealers to stop providing this commentary to regulated funds, particularly smaller funds, because of the difficulty (or near impossibility) of complying with rules 2241 and 2242 for this type of information.[7]

We applaud FINRA for proposing a practical solution—in the form of a safe harbor—for desk commentary to continue to be delivered to institutional investors.[8] An appropriately-tailored safe harbor would alleviate concerns that FINRA's rules on research reports will reduce the flow of desk commentary to institutional investors by giving the providers of desk commentary certainty about the regulatory obligations that attach to these communications. The certainty offered by a safe harbor would be most helpful when regulators question whether certain desk commentary "fall[s] just on either side of the line" of being a research report—and should help ensure that regulated funds continue to receive desk commentary. A safe harbor also would allow a broker-dealer, if appropriate, to elect not to use the relief if it determines that certain desk commentary falls outside the definition of research report.[9]

We recommend one change to the conditions that FINRA proposes to require a broker-dealer to satisfy to rely on the safe harbor. The proposed condition that a broker-dealer receive negative consent from all desk commentary recipients could have unintended adverse consequences for regulated funds and other institutional investors, and we recommend that FINRA not condition the safe harbor on recipient consent. In recent years, broker-dealers have attempted to use negative consent to update existing agreements or impose new obligations on the buy-side. Conditioning the receipt of

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[5] *See* FINRA rule 2241(b)(1)(C).

[6] *See* FINRA rule 2241(c).

[7] FINRA rules provide an exception from the definition of "research report" and "desk research report" for any communications prepared for a specific person or a limited group of fewer than 15 persons. Broker-dealers could use this exception to continue delivering desk commentary to large clients, even if FINRA takes the view that certain desk commentary technically meets the definition of research report or debt research report.

[8] To rely on the safe harbor, a broker-dealer would need to receive negative consent from the recipients of desk commentary, ensure that safe harbor communications satisfy certain author, content, and recipient criteria, and comply with selected portions of FINRA's research rules "to mitigate the most serious research-related conflicts that can be present with desk commentary." *See* Proposal at 5.

[9] To avoid any confusion about the operation of the safe harbor, we suggest that FINRA consistently refer to the material eligible for the proposed safe harbor as "safe harbor commentary" and use the term "desk personnel" to refer to the individuals that produce this commentary.

desk commentary on negative consent would, at a minimum, require regulated funds to ensure that broker-dealers do not use the negative consent process for desk commentary to affect other, unrelated unilateral changes in existing relationships. We believe the proposed safe harbor should impose no new burdens on desk commentary recipients. Moreover, conditioning use of the safe harbor on negative consent is unnecessary because the health warning that would accompany each piece of desk commentary would provide adequate notification and protections to institutional investors. [10] Institutional investors also are capable of refusing or ignoring desk commentary that they do not find useful.

Finally, we strongly encourage FINRA to continue to work with the broker-dealer community to ensure that the practical approach offered by the safe harbor will, in fact, grant compliance certainty to the providers of desk commentary and then to advance the Proposal as quickly as possible.[11] Adopting a workable safe harbor quickly will promote certainty and ensure that buy-side traders continue to receive at least the most salient types of desk commentary.

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We appreciate the opportunity to comment on the Proposal. If you have any questions on our comment letter, please feel free to contact me at (202) 326-5815, Jennifer Choi, Associate General Counsel, at (202) 326-5876, or George Gilbert, Counsel, at (202) 326-5810.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel

cc: Robert Colby, General Counsel
Philip Shaikun, Vice President and Associate General Counsel
Jeanette Wingler, Associate General Counsel

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[10] Desk commentary and other broker-dealer communications that are not research reports are still subject to other FINRA rules, including rule 2210 (Communications with the Public). This rule imposes training, review and recordkeeping requirements, and content standards on written communications from FINRA members, including desk commentary. Other FINRA and SEC rules govern broker-dealer business conduct and provide adequate safeguards if broker-dealers engage in fraud or other misconduct in connection with providing desk commentary.

[11] *See e.g.*, Letter from Sean Davy, Managing Director, SIFMA, to Jennifer Piorko Mitchell, FINRA, dated May 31, 2017, *available at* http://www.finra.org/sites/default/files/notice_comment_file_ref/17-16_SIFMA_comment.pdf.