

SECURITIES AND EXCHANGE COMMISSION
(Release No. 72480; File No. SR-FINRA-2014-012)

June 26, 2014

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Filing of a Proposed Rule Change To Amend FINRA Rules 2210 (Communications with the Public) and 2214 (Requirements for the Use of Investment Analysis Tools)

I. Introduction

The Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) on March 25, 2014, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to (i) amend FINRA Rule 2210 (Communications with the Public) to exclude from the filing requirements research reports concerning only securities listed on a national securities exchange, other than research reports which must be filed pursuant to Section 24(b) of the Investment Company Act of 1940 (“1940 Act”)³; (ii) amend FINRA Rule 2210 to clarify that free writing prospectuses that are exempt from filing with the SEC are not subject to the rule’s filing or content standards; and (iii) correct a mistaken rule cross-reference in FINRA Rule 2214 (Requirements for the Use of Investment Analysis Tools). The proposed rule change was published for comment in the Federal Register on March 31, 2014.⁴

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 80a-24(b).

⁴ See Securities Exchange Act Release No. 34-71792 (March 31, 2014), 79 FR 18094 (SR-FINRA-2014-012) (“Notice”).

The Commission received four comments in response to the proposed rule change.⁵ This order approves the proposed rule change.

II. Description of the Proposed Rule Change

(a) Filing Exclusion for Research Reports on Exchange-Listed Securities

As further described in the Notice, FINRA proposed to amend the current requirements for members to file certain retail communications with the Advertising Regulation Department (the “Department”). Under this amendment, members would no longer be required to file research reports that concern only securities listed on a national securities exchange. Between the dedicated protections applied to research reports by other FINRA and SEC rules, and the increased liquidity and price transparency associated with exchange-listed securities, FINRA stated its belief that the additional investor protection benefit of Department review of those retail communications is minimal in relation to the cost of compliance and administration of the filing requirement. This exclusion will not apply to research reports that must be filed under Section 24(b) of the 1940 Act.

(b) Clarification Regarding Free Writing Prospectuses Exempt from SEC Filing

FINRA proposed to amend FINRA Rule 2210(c)(7)(F) and FINRA Rule 2210(d)(8) to exclude from the filing and content standards free writing

⁵ Letters from Jason Doss, President, Public Investors Arbitration Bar Association, dated April 15, 2014 (“PIABA”); Carrie Devorah, dated April 17, 2014 (“Devorah”); Dorothy Donohue, Acting General Counsel, Investment Company Institute, dated April 21, 2014 (“ICI”); and Stephanie Nicolas, Wilmer Cutler Pickering Hale and Dorr LLP, on behalf of Barclays Capital Inc., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Goldman, Sachs & Co., J.P. Morgan Securities LLC, Merrill Lynch, Pierce Fenner & Smith Incorporated, Morgan Stanley & Co. LLC, and RCS Capital Markets, LLC (“WilmerHale”).

prospectuses that are exempt from filing with the SEC. FINRA also proposed to clarify that the filing and content requirements apply to free-writing prospectuses required to be filed with the SEC pursuant to Securities Act Rule 433(d)(1)(ii).⁶

(c) Correction of Rule Cross-Reference in FINRA Rule 2214

Paragraph (a) of FINRA Rule 2214 (Requirements for the Use of Investment Analysis Tools) mistakenly cross-references FINRA Rule 2210(c)(3)(D) (the filing requirement for retail communications concerning collateralized mortgage obligations).⁷ Rule 2214(a) should cross-reference Rule 2210(c)(3)(C) (the filing requirement for any template for written reports produced by, or retail communications concerning, an investment analysis tool). FINRA proposed to correct this rule cross-reference.

FINRA stated that it would announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be the date of publication of the Regulatory Notice announcing Commission approval.

III. Comment Letters

The SEC received four comment letters.⁸ Two commenters expressed support for the proposal⁹ and two opposed it.¹⁰ The Commission also received FINRA's response to comments, which is discussed below.¹¹

⁶ 17 CFR 230.433(d)(1)(ii).

⁷ See Securities Exchange Act Release No. 66681 (March 29, 2012), 77 FR 20452 (April 4, 2012) (SR-FINRA-2011-035).

⁸ See supra note 5.

⁹ See ICI and WilmerHale Letters.

¹⁰ See PIABA and Devorah Letters.

(a) Overall Support for Proposal

One commenter agreed with FINRA’s assessment that the proposed filing exclusion is appropriate based on the fact that research reports are already subject to regulation under NASD Rule 2711 (Research Analysts and Reports), that securities listed on a national securities exchange are less likely to be subject to price manipulation, that research reports may only be produced by persons who have passed the appropriate qualification examinations, and that the FINRA staff has not seen significant problems with research reports on exchange-listed securities that have been filed with FINRA.¹² The commenter also stated that the filing exclusion may facilitate more timely and efficient dissemination of information about closed-end funds to the market.¹³

Another commenter similarly supported the proposal based on its belief that equity research reports on exchange-listed securities do not implicate investor protection concerns.¹⁴ However, the commenter recommended that the proposed exclusion be expanded to cover all other equity research materials concerning exchange-listed securities that do not meet the definition of “research report” under NASD Rule 2711(a)(9).¹⁵ The commenter believed that this expanded exclusion would be consistent with the approach FINRA has taken for purposes of other parts of FINRA

¹¹ Letter from Joseph P. Savage, FINRA, dated June 18, 2014 (“FINRA Letter”).

¹² See ICI Letter.

¹³ Id.

¹⁴ See WilmerHale Letter.

¹⁵ Id.

Rule 2210, such as the provisions that allow a supervisory analyst to approve research communications.¹⁶

The commenter also argued that this expansion is appropriate because exchange-listed securities are associated with increased liquidity and price transparency, and thus research communications concerning such securities do not raise the same investor protection concerns as communications concerning other more illiquid securities.¹⁷ In addition, the commenter stated that research communications—which are not research reports—are still prepared in a controlled environment that is designed to reduce the potential for conflicts of interest, and research analysts that produce such communications are subject to comprehensive independence requirements of NASD Rule 2711.¹⁸

The commenter urged FINRA to consider amending FINRA Rule 2210 to provide a comparable filing exclusion for debt research reports if and when a FINRA rule regarding debt research is approved.¹⁹ The commenter believed that the requirements and protections of such a rule would justify an exclusion from the filing requirements for research reports on debt securities.²⁰

¹⁶ Id. (citing FINRA Rule 2210(b)(1)(B)).

¹⁷ Id.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

(b) Opposition to Rule Proposal

One commenter opposed the proposed filing exclusion for research reports on exchange-listed securities because its members believe that the amendment is misguided and runs counter to FINRA's stated objective of investor protection.²¹ The commenter stated that the securities industry is not far removed from the research analyst scandals which were based in part on misinformation and lack of transparency.²² The commenter also argued that the costs of filing such reports is a small price to pay for the additional protection it gives to investors and that the filing requirement is essential for restoring investor confidence.²³

Another commenter submitted a letter that comments on a number of provisions of FINRA Rule 2210.²⁴ The letter contains a wide variety of observations and concerns regarding FINRA rules, including that FINRA's regulation of member firm communications should promote transparency.²⁵ However, the letter does not comment on the proposed filing exclusion for research reports concerning exchange-listed securities.²⁶

²¹ See PIABA Letter.

²² Id.

²³ Id.

²⁴ See Devorah Letter.

²⁵ Id.

²⁶ Id.

(c) Response to Comments

FINRA responded to these comments by stating that it does not believe it is appropriate either to withdraw the proposal or to amend the proposal as suggested.²⁷ FINRA also noted that it does not believe it is appropriate to expand the filing exclusion to cover research communications that do not meet the definition of research report.²⁸ FINRA stated that unlike research reports, other research communications are not subject to the comprehensive disclosure, content and analyst independence provisions of NASD Rule 2711 and SEC Regulation Analyst Certification, nor is there any requirement that a registered research analyst prepare such communications.²⁹ Accordingly, FINRA asserted that it does not agree that the same investor protections apply to research communications that are not research reports.³⁰

FINRA also stated that it is premature to commit to an exclusion from the filing requirements for research reports concerning debt securities in anticipation of FINRA adopting a debt research rule.³¹ FINRA noted that it would be more appropriate to consider such a proposal if and when a proposed debt research rule is filed with the SEC and approved.³²

²⁷ See FINRA Letter.

²⁸ Id.

²⁹ Id.

³⁰ Id.

³¹ Id.

³² Id.

In its letter, FINRA disagreed that the benefits to investors of requiring firms to file research reports concerning exchange-listed securities exceed the costs associated with such filing.³³ FINRA also noted that while it agrees that the research analyst scandals that occurred a decade ago raised a number of investor protection concerns, FINRA responded to such concerns by adopting NASD Rule 2711, and Congress also imposed requirements on firms that produce research reports as part of the Sarbanes-Oxley Act.³⁴ FINRA responded that its experience since Rule 2711 took effect is that it has significantly reduced the problems that occurred prior to the adoption of the rule, and that also requiring research reports concerning exchange-listed securities to be filed with FINRA does not appreciably increase investor protection relative to the costs associated with filing.³⁵

Moreover, FINRA noted that by requiring firms to file research reports with FINRA, it is diverting FINRA staff resources that must be applied to review of these communications.³⁶ FINRA stated that it believes such resources would be better spent on

³³ Id.

³⁴ Id. (citing 15 U.S.C. § 15D).

³⁵ See FINRA Letter (citing Joint Report by NASD and the NYSE On the Operations and Effectiveness of the Research Analyst Conflict of Interest Rules (December 2005), available at www.finra.org; U.S. Government Accountability Office, Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (January 2012), available at www.gao.gov).

³⁶ Id.

higher risk communications, and that by re-allocating such resources, FINRA will be indirectly increasing the regulatory benefits to investors.³⁷

IV. Discussion and Findings

After careful review of the proposed rule change, the comments, and FINRA's response to the comments, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.³⁸ In particular, the Commission finds that the proposal to exclude research reports concerning only exchange-listed securities from the filing requirements for certain retail communications is consistent with the provisions of Section 15A(b)(6) of the Act,³⁹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed exclusion should reduce the burdens imposed on member firms that would otherwise have to file research reports on exchange-listed securities with FINRA, while continuing to protect investors through the protections provided by FINRA Rule 2210 and NASD Rules 1022, 1050 and 2711.

³⁷ See FINRA Letter (citing Joint Report by NASD and the NYSE On the Operations and Effectiveness of the Research Analyst Conflict of Interest Rules (December 2005), available at www.finra.org; U.S. Government Accountability Office, Securities Research: Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest (January 2012), available at www.gao.gov).

³⁸ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 17c(f).

³⁹ 15 U.S.C. 78q-3(b)(6).

The Commission also finds that the proposed clarification (consistent with FINRA’s current interpretation of Rule 2210) regarding the application of Rule 2210’s filing and content standards to free writing prospectuses that are exempt from filing with the SEC is consistent with the provisions of Section 15A(b)(6) of the Act.⁴⁰

The Commission further finds that the proposed correction of the rule cross-reference in FINRA Rule 2214 is consistent with the provisions of Section 15A(b)(6) of the Act.⁴¹

The correction of the cross-reference is consistent with the Rule’s intent and purpose and will reduce any potential confusion due to the current incorrect cross-reference.

In general, the Commission believes that FINRA has responded to the comments adequately, and has explained how the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.

⁴⁰ 15 U.S.C. 78o-3(b)(6).

⁴¹ 15 U.S.C. 78o-3(b)(6).

V. Conclusions

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴² that the proposed rule change (SR-FINRA-2014-012) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴³

Kevin M. O'Neill
Deputy Secretary

⁴² 15 U.S.C. 78s(b)(2).

⁴³ 17 CFR 200.30-3(a)(12).