PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
2415 A Wilcox Drive | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

December 15, 2014

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

Re: File Number SR-FINRA-2014-047
Proposed Rule Change re Equity Research Analysts & Research Reports

Dear Secretary Fields:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by the Financial Industry Regulatory Authority ("FINRA") to govern the conduct of securities firms and their representatives. In particular, our members and their clients have a strong interest in FINRA rules relating to the information provided to investors.

For some time, FINRA has struggled to ensure the integrity of equity research reports. Over a decade ago, these failures came to light when then New York State Attorney General Elliot Spitzer published Henry Blodget's emails in which he provided private assessments concerning equity securities that seemingly contradicted his public research. The Securities and Exchange Commission (the "Commission") subsequently charged Mr. Blodget with securities fraud and eventually reached a settlement agreement in which Mr. Blodget was permanently barred from the securities industry. Congress also responded to the scandal as it passed the Sarbanes-Oxley Act of 2002 ("SOX").[1] SOX devotes an entire title, Title V, to measures designed to restore investor confidence in the integrity of securities analyst opinions.

Despite these previous efforts to improve the integrity of analyst reports, significant concerns remain. A few weeks ago, on November 24, 2014, FINRA fined Citigroup Global Markets Inc. $15 million for supervisory failures related to equity research involvement in IPO roadshows. Just a few days ago, FINRA announced still more fines: $43.5 million against ten different FINRA members for offering favorable equity research coverage in exchange for investment banking business. The fines reveal that the supposedly impenetrable wall erected between investment banking and equity research is, in truth, too often porous. Indeed, the press release for the Citigroup fine indicates that ineffective Citigroup compliance personnel had limply chastised research analysts for approximately *one hundred* improper communications before the events giving rise to the fine.

[1] Pub.L. 107–204, 116 Stat. 745, enacted July 30, 2002.

Self-regulation and supervision cannot be deemed effective unless they actually alter behavior. FINRA itself noted that "the disciplinary measures lacked the severity necessary to deter repeat violations."[2]

While PIABA generally supports the proposed rule change and believes that it most likely will, on the whole, improve the integrity of equity research reports, the proposed rule's provisions will do little good without adequate enforcement. In moving forward, we urge the Commission to encourage FINRA to increase its oversight if it hopes to preserve the privilege of self-regulation.

The proposed rule does contain some significant improvements – presuming they are enforced. In particular, PIABA supports the alterations making the rule more expansive and effective. FINRA's alteration of the definition of "investment banking services" to include "all acts in furtherance of any public or private offering on behalf of an issuer"[3] is a particularly good expansion. The broader definition should grant FINRA the ability to prevent financial institutions from using their complicated organizational charts to avoid the law's spirit through technical compliance. Similarly, PIABA also applauds FINRA's decision to expand the separation between research and investment banking to also separate research from sales and trading or other personnel that may benefit from corrupting the work of research analysts.

Despite these improvements, the proposed rule does not always reach far enough to ensure that investors receive untainted advice. Of particular concern to PIABA is the fact that proposed FINRA Rule 2241.07 allows FINRA members to disseminate research telling some investors to buy a particular security while at the exact same moment disseminating research to other investors advising them to sell the same security.

Instead of requiring its members to tell investors about specific contrary recommendations, FINRA proposes to address the doubletalk by adding a mind-numbing, prophylactic disclosure notifying the investors that different investors may receive different advice about the same security's prospects. Proposed FINRA Rule 2241.07 merely provides that:

> a member that provides different research products and services for different customers must inform its other customers that its alternative research products and services may reach different conclusions or recommendations that could impact the price of the equity security. Thus, for example, a member that offers trading research must inform its investment research customers that its trading research product may contain different recommendations or ratings that could result in short-term price movements contrary to the recommendation in its investment research.[4]

The suggested disclosure that the FINRA member *may* offer different opinions to different clients regarding the same security means nothing. It should be obvious that different opinions offered to different clients is a material fact – and one that should be disclosed. Merely disclosing that there "may" be differing conclusions

[2] FINRA, *FINRA Fines Citigroup Global Markets Inc. $15 Million for Supervisory Failures Related to Equity Research and Involvement in IPO Roadshows*, (Nov. 24, 2014), h*ttp://www.finra.org/Newsroom/NewsReleases/2014/P601793.*
[3] Proposed FINRA Rule 2241(a)(5).
[4] Proposed FINRA Rule 2241.07.

doesn't inform a potential investor that there *are* differing conclusions. Advising the client that it may rain is disingenuous if the advisor knows with 100% certainty that it is actually going to rain.

This provision appears to exist in tension with Rule 10b-5 because it allows FINRA member firms to substitute a vague disclosure of a possible (and undescribed) danger for the truth. Rule 10b-5 prohibits the making of "any untrue statement of a material fact *or to omit to state a material fact* necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading".[5] Interpreting this provision, the Supreme Court has identified material omissions as facts omitted when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (internal quotation and citation omitted). A reasonable investor would want to know that her trustworthy FINRA member firm advised others to sell while recommending that she buy.

The proposed disclosure wholly fails to apprise the investor of any actual contrary research recommendation being issued by the FINRA member firm. It apparently tells the investor that she cannot rely upon the research report presented for the full truth without also reading every other contemporaneous research report about the issuer provided through every other channel—whether or not the investor has paid for access to the alternative channels.

FINRA should require its member firms to actually disclose when its research products or services do, in fact, contain a recommendation contrary to the research product or service other customers receive. This requirement should not burden FINRA's firms. Presumably they are aware of the recommendations they make about different securities and when those recommendations may differ. FINRA should require its member firms to provide the complete truth to investors and not condone FINRA member firms' provision of distribution-channel-specific half-truths.

Very truly yours,

Hugh D. Berkson
President-Elect, PIABA

[5] 17 C.F.R. 240.10b-5(b) (emphasis added).