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May 5, 2015

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: File Nos. SR-FINRA-2014-047 (Research Analysts and Research Reports)  
and SR-FINRA-2014-048 (Debt Research Analysts and Debt Research  
Reports)**

Dear Mr. Fields:

On February 20, 2015, the Securities and Exchange Commission (“SEC” or “Commission”) issued orders initiating proceedings to determine whether to approve or disapprove the above-referenced rule filings related to equity research analysts and equity research reports (“equity proposal”) and debt research analysts and debt research reports (“debt proposal”) (together “the proposals”).<sup>1</sup> On March 18, 2015, the Commission published for comment in the Federal Register Amendments No. 1 to the respective proposals (together “the March 2015 Amendments”).<sup>2</sup>

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<sup>1</sup> See Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook, Release No. 34-74339, 80 Fed. Reg. 10528 (February 26, 2015); and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports), Release No. 34-74340, 80 Fed. Reg. 10538 (February 26, 2015).

<sup>2</sup> See Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook, Release No. 34-74488, 80 Fed. Reg. 14174 (March 18, 2015); and Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports), Release No. 34-74490, 80 Fed. Reg. 14198 (March 18, 2015).

The Commission received two comment letters that addressed the equity proposal,<sup>3</sup> three directed to the debt proposal,<sup>4</sup> and one addressed to both proposals.<sup>5</sup> One commenter expressed strong support for several of the changes in the March 2015 Amendments, noting that they should help reduce some of the burdens and costs associated with the proposals without compromising investor protection.<sup>6</sup> However, that commenter also asked for two discrete changes to the proposals and clarification with respect to the application of a provision common to the proposals. Another commenter stated that the amendment to the debt proposal substantially alleviated its prior concerns, but encouraged additional guidance and prospective monitoring.<sup>7</sup> One commenter expressed concerns with several provisions of the equity proposal,<sup>8</sup> while another repeated previous concerns with the proposals in addition to some new ones raised by the March 2015 Amendments.<sup>9</sup> FINRA responds to the commenters' concerns below.

### Comments Addressed to Both Proposals

One commenter reiterated its view that FINRA should maintain the prescriptive approach of current NASD Rule 2711, rather than adopt the proposed policies and procedures approach in the proposals.<sup>10</sup> The commenter suggested in its letter on the equity proposal that “the current prescriptive regime should remain, while the proposed policies and procedures approach should be added to the existing framework.” The commenter further stated that by deleting language that would have required the firm’s policies and procedures to be reasonably designed to “at a minimum” prohibit or restrict specified conduct, FINRA “has removed the prescriptive nature of the rules entirely.”

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<sup>3</sup> Letter from Egidio (Gil) Mogavero, Chief Compliance Officer, JMP Securities LLC, to Brent J. Fields, Secretary, SEC, dated March 19, 2015 (“JMP”); letter from William Beatty, President and Washington Securities Administrator, North American Securities Administrators Association, Inc., to Brent J. Fields, Secretary, SEC, dated April 17, 2015 (“NASAA Equity”).

<sup>4</sup> Letter from Kurt N. Schacht, Managing Director, Standards and Financial Market Integrity, and Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute, to Brent J. Fields, Secretary, SEC, dated April 7, 2015 (“CFA Institute”); Letter from William Beatty, President and Washington Securities Administrator, North American Securities Administrators Association, Inc., to Brent J. Fields, Secretary, SEC, dated April 17, 2015 (“NASAA Debt”); and Anonymous email dated April 8, 2015 (“Anonymous”). While the Anonymous comment was submitted in response to the debt proposal, its content does not clearly relate to any aspect of that proposal or the equity proposal. Accordingly, FINRA has not responded to the comments in this email.

<sup>5</sup> Letter from Stephanie R. Nicolas, Wilmer Cutler Pickering Hale and Dorr LLP, to Brent J. Fields, Secretary, SEC, dated April 6, 2015 (“WilmerHale”).

<sup>6</sup> WilmerHale.

<sup>7</sup> CFA Institute.

<sup>8</sup> JMP.

<sup>9</sup> NASAA Equity; NASAA Debt.

<sup>10</sup> NASAA Equity; NASAA Debt.

The same commenter asserted in its letter that FINRA also weakened the prescriptive nature of the current rules by deleting in the March 2015 Amendments language in supplementary material that stated that “[f]ailure of an associated person to comply with such policies and procedures shall constitute a violation of this Rule.”<sup>11</sup>

FINRA disagrees with the comments. As FINRA discussed in detail in both the original proposed rule changes and March 2015 Amendments, the proposed framework effectively maintains, with a few modifications, the key proscriptions in the current rules. This is because the proposals require policies and procedures that *must* prohibit or restrict specified conduct, such as research analyst participation in soliciting investment banking business or road shows. As FINRA further explained in detail in the March 2015 Amendments, the removal of the “at a minimum” language was meant to clarify that FINRA did not expect firms’ written policies and procedures to go beyond the specified prohibitions and restrictions in the proposals where no new conflicts had been identified. However, FINRA also noted that removing that language did not change the overarching requirement for written policies and procedures reasonably designed to identify and effectively manage emerging conflicts – a significant additional obligation that does not exist in the current rules. FINRA also explained in detail in the March 2015 Amendments that deleting the language in the supplementary material would not alter achievement of the intended purpose of that material: to hold individuals responsible for engaging in conduct that the policies and procedures effectively restrict or prohibit. Moreover, FINRA does not believe a failure to follow administrative procedures, for example, should result in a violation of the underlying rule. Accordingly, the amended supplementary material more narrowly and appropriately achieves the regulatory objective.

One commenter asked FINRA to modify in both proposals the supplementary material related to the requirement to disclose in research reports “any other material conflict of interest” of a member that “an associated person with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.”<sup>12</sup> The March 2015 Amendments revised Supplementary Material .08 and .07 of the equity and debt proposals, respectively, to define an associated person with the ability to influence the content of a research to mean, with respect to a particular research report, an associated person who is required to review the content of the research report or has exercised authority to review or change the research report prior to publication or distribution. The amended definition also excluded legal or compliance personnel who may review a research report for compliance purposes but are not authorized to dictate a particular recommendation, rating or price target.

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<sup>11</sup> While these comments were contained in the NASAA Equity letter, the provisions and changes they address would have equal applicability to the debt proposal.

<sup>12</sup> WilmerHale.

The commenter acknowledged and appreciated the changes FINRA made to these provisions in the March 2015 Amendments, but asked FINRA to further limit its application. Specifically, the commenter asked that the definition apply only to individuals who review a report if that person has the authority to dictate or change material research views.

FINRA declines to make the further change. The exclusion for legal or compliance was meant to limit application of the provision where there is a discrete review by those persons outside of the research department who do not have primary content review responsibilities. FINRA believes those individuals that a firm requires to review research reports (e.g., a Supervisory Analyst) or who exercise their authority to change a research report (e.g., a Director of Research) by definition have the ability to influence the content of a research report.

The commenter also stated that it interprets proposed Rules 2241(b)(2)(G) and 2242(b)(2)(H)<sup>13</sup> to continue to permit persons engaged in sales and trading activities to provide feedback on research analysts as part of research management's evaluation process. The commenter stated that firms understand these provisions to require member firms to establish policies, procedures and controls to insulate or protect research analysts from being evaluated on the basis of inappropriate or improper reviews by such persons; for example, where such persons negatively review an analyst because the analyst was unwilling to give the sales person a "heads up" on a rating change. The commenter noted that its interpretation was consistent with NASD Rule 2711, which requires consideration of ratings received from the sales force as part of the review and approval process for research analyst compensation, as well as other provisions of the proposed rules, which do not prohibit sales and trading personnel from conducting reviews or providing input into the evaluation of research analysts (but do expressly prohibit investment banking and principal trading personnel from specified conduct). In general, FINRA agrees with the commenter's interpretation.

#### Comments to the Equity Proposal

One commenter asked FINRA to clarify that senior managers who oversee the equity research department in addition to other departments are "exempt" from the provision that requires a member to establish, maintain and enforce policies and procedures reasonably designed to identify and effectively manage conflicts of interest

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<sup>13</sup> Proposed Rule 2241(b)(2)(G) would require firms to establish, maintain and enforce written policies and procedures that establish information barriers or other institutional safeguards reasonably designed 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 personnel, who might be biased in their judgment or supervision.

Proposed Rule 2242(b)(2)(H) requires similar written policies and procedures that establish information barriers or other institutional safeguards reasonably designed to ensure that debt research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking activities, principal trading or sales and trading activities, or other persons who might be biased in their judgment or supervision.

related to the interaction between research analysts and those outside of the research department, including investment banking and sales and trading personnel, subject customers and companies.<sup>14</sup> The commenter asserted that in smaller firms, a senior manager who is, or oversees, the Director of Research may also oversee the sales and trading or investment banking departments and “must provide input” to fulfill their supervisory duties. The commenter further asserted that despite wearing multiple hats, in practice these managers do not risk compromising the best interests of the research department in favor of another department. The commenter further contended that the rule should expressly permit senior managers who have multiple managerial responsibilities, including supervising the Director of Research, to conduct prepublication review of research reports.

There is no express exemption in the proposal for senior managers who oversee the research department, as well as other departments. However, FINRA notes that the equity proposal includes an exemption for firms with limited investment banking activity. That exemption is available to firms that over the previous three years, on average per year, have participated in 10 or fewer investment banking transactions as manager or co-manager and generated \$5 million or less in gross investment banking revenues from those transactions. Eligible firms would be exempt from several of the structural separation provisions, including the prohibition and restrictions on pre-publication review by persons engaged in investment banking services activities and other persons not directly responsible for the preparation, content and distribution of research reports, respectively. Apart from this exemption, as discussed in the debt proposal with respect to sales and trading personnel, FINRA does not intend to capture as an investment banker or sales and trading personnel a senior manager who does not engage in or directly supervise day-to-day investment banking services activities (e.g., soliciting potential investment banking clients or structuring offerings) or sales and trading activities.

The commenter also asked FINRA to interpret selling concessions from public financings not to constitute compensation based on specific investment banking services transactions. The commenter asserted that concessions are “effectively commission revenue” generated from salespeople and are therefore different from investment banking revenue paid by an issuer. The commenter further asserted that research analysts assist the sales force by educating potential investors and therefore should be able to be compensated directly from those revenues.

The current rules and equity proposal prohibit research analyst compensation based upon specific investment banking services transactions or contributions to a member’s investment banking services activities. This provision is intended to eliminate a conflict where a research analyst could be incented to give an overly optimistic outlook on a subject company to potential investors in an offering, either in direct communications or published research, because they would be compensated based on the success of that offering. The selling concession is a component of the gross spread, the means by which an issuer compensates underwriters in an offering. As such, it is

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<sup>14</sup> JMP.

compensation based upon a specific investment banking services transaction. To regard it otherwise, as the commenter suggested, would reintroduce the very conflict that FINRA believes the provision has, in combination with other provisions, effectively alleviated.

The commenter further asked for additional clarity regarding the terms “manager” and “co-manager” as they related to quiet periods after a secondary offering. The proposal would require a member to define a quiet period of a minimum of three days following the date of a secondary offering if the member has acted as a manager or co-manager of the offering. The commenter suggested that the terms describe a large proportion of deal participants and that the lead firms are called “lead manager” or “book-running manager.”

FINRA believes the terms “manager” and “co-manager” are commonly understood by participants in an offering and has not been made aware of any confusion in that regard since the current quiet periods came into existence. Moreover, FINRA believes terms like “lead manager” or “book-running manager” equate to “manager” for the purposes of the proposed quiet period provision. FINRA notes that the quiet period after a secondary offering in the equity proposal would apply equally to managers and co-managers.

The commenter also asked for clarification as to how the prohibition on joint due diligence is to be interpreted in light of the JOBS Act. That provision would require policies and procedures reasonably designed to prohibit the performance of joint due diligence by a research analyst in the presence of investment banking personnel prior to the selection by the issuer of the underwriters for an investment banking transaction. FINRA would interpret the provision to apply only to the extent it is not contrary to the JOBS Act. Among other things, the JOBS Act prohibits FINRA from restricting an analyst from participating in any communications with the management of an emerging growth company (“EGC”) that is also attended by another associated person of a broker-dealer whose functional role is other than as a research analyst. Thus, for example, FINRA would not interpret the joint due diligence prohibition to apply where the joint due diligence activities involve a communication with the management of an EGC that is attended by both the research analyst and an investment banker.

The same commenter also contended that the requirement in current NASD Rule 2711(h)(2)(A)(ii)c and proposed FINRA Rule 2241(c)(4)(C)(iii) to disclose in a research report if a member or its affiliate expects to receive or intends to seek compensation for investment banking services in the next three months provides no meaningful input, is burdensome and could tip the market to material non-public information. JMP instead suggested disclosure of whether the subject company is a “current” client of the firm.

FINRA notes that the current and proposed equity rules already require disclosure if the subject company is, or over the 12 month period preceding the date of publication or distribution of the research report, has been a client of the member. The equity proposal also maintains the exception in the current rule for disclosure to the extent such disclosure would reveal material non-public information regarding specific future

investment banking transactions of the subject company. As such, the concern about tipping the market has already been addressed in the equity proposal.

The requirement to disclose if the member expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months is intended to illuminate for the investor the material conflict of interest with respect to the objectivity of a research report published or distributed at a time when the member is or anticipates seeking investment banking business from the subject company or is in the process of, for example, managing an upcoming offering. Given the materiality of the conflict, the disclosure would be required under the “catch all” provision even if the specific disclosure provision were eliminated. In addition, FINRA set out in the proposed rule change evidence to support the effectiveness of the existing rules, while the commenter offers no evidentiary support for its contention that the disclosure provides no meaningful input to investors, particularly retail investors. Accordingly, FINRA has not proposed to change the provision.

The commenter agreed that firms must establish and maintain policies and procedures reasonably designed to shield its analysts from pressure from others outside of the research department but suggested a “bit of leeway or guidance” should be provided for the benefit of small firms or those only with institutional clients. The policies and procedures requirements are principles-based and intended to allow flexibility based on firm size and business model, so long as they are reasonably designed to achieve compliance with the rules. FINRA will consider providing additional guidance, as appropriate, where questions arise.

One commenter reiterated a previous concern that the current quiet periods in the equity rules should be maintained and not shortened.<sup>15</sup> The commenter expressed concern that the shorter quiet periods would result in a greater likelihood that firms would promise favorable research coverage because research could be released more quickly after an offering. The commenter did not explain the connection between shorter quiet periods and promises of favorable research or offer additional reasoning or support for maintaining the lengthier quiet period. On the other hand, FINRA explained in detail in the original proposed rule change its reasoning to reduce the quiet periods, including evidentiary and anecdotal support. Accordingly, FINRA has maintained the quiet periods as proposed.

#### Comments to the Debt Proposal

One commenter<sup>16</sup> renewed a request to allow debt research analysts to attend road shows in person, with limitations, because debt research analysts do not have the same opportunity to meet with issuer management. For the reasons set forth in detail in the

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<sup>15</sup> NASAA Equity.

<sup>16</sup> WilmerHale.

proposed rule change and Amendment No. 1, FINRA declines to make the suggested change.

Another commenter<sup>17</sup> appreciated the examples provided by FINRA in the debt proposal amendment as to how firms might protect debt research analysts from pressure by sales and trading personnel under the exemptions for firms with limited principal trading and limited investment banking activity, but asked for additional guidance to help ensure compliance with the spirit of the rule. The commenter stated that FINRA's examples, "depending on the methods used," "may or may not" result in compliance. In addition, the commenter applauded FINRA's commitment to monitor the exemptions to assess whether the thresholds are appropriate or should be modified and encouraged FINRA to publish the findings.

FINRA notes that the proposal requires policies and procedures reasonably designed to protect against pressure. As such, FINRA believes there are different ways a firm might design its compliance system with respect to the requirement. The examples given are not intended to be dispositive of a reasonably designed system, only to give examples of what a compliant system might include. As the commenter noted, FINRA will monitor the effectiveness and impact of the exemptions. FINRA also will consider sharing its findings in an appropriate manner (e.g., in support of any amendment).

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FINRA believes that the foregoing responds to the material issues raised by the commenters to these rule filings. If you have any questions, please contact either Jeanette Wingler at [REDACTED], email: [REDACTED]; or me at [REDACTED], email: [REDACTED]. The fax number of the Office of General Counsel is [REDACTED].

Very truly yours,



Philip Shaikun  
Vice President and  
Associate General Counsel

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<sup>17</sup> CFA Institute.