Exhibit 2c

Public Investors Arbitration Bar Association

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April 2, 2012

Via Email Only
pubcom@finra.org

Marcia Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-09; Debt Research Reports

Dear Ms. Asquith:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"). PIABA is a 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. Our members and their clients have a strong interest in FINRA rules relating to both investor protection and disclosure.

Regulatory Notice 12-09, represents a year's worth of comments and research put forth in response to Regulatory Notice 11-11. Regulatory Notice 12-09 is an improvement of Reg. Notice 11-11, and proposes to apply safeguards and disclosure requirements to the publication and distribution of debt research reports. PIABA generally support the proposal and believes that the proposed rule is a long overdue step in the right direction.

Although Regulatory Notice 12-09 is an improvement to Reg. Notice 11-11, it leaves noteworthy gaps. PIABA believes that disclosure is paramount to the functioning of a fair and efficient free market. Without consistent and disseminated information on conflicts of interest on all research for all debt securities, the marketplace will continue to function in the conflict-laden way it now operates. This necessarily is detrimental to both retail and institutional investors. Research reports have long been used for both debt and equity securities. Without a regulatory requirement, many firms failed to adhere to the "Guiding Principles." FINRA needs to do more to protect investors especially in light of Wall Street's increasing use of complex, risky debt products (mortgage backed securities, CDOs, auction rate securities, structured debt products, reverse convertibles, etc.). A framework is needed to properly regulate the research of debt securities.

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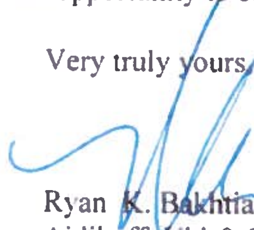
It is unfortunate that the proposal excludes "municipal securities" from the definition of "debt security." It is PIABA's belief that FINRA has not adequately demonstrated why municipal securities (and the research related to them) should be afforded different treatment from other debt securities. FINRA should not rely on a jurisdictional limitation in excluding municipal securities from the proposed rule. To ensure market integrity, municipal securities must be covered by the proposed rule. FINRA should do more -- not less -- to ensure all investors are provided with fair, honest, and trustworthy information with respect to municipal securities.

PIABA believes that FINRA has also mistakenly excluded another large segment of debt securities from the definition of "debt security" which are "security-based swaps". FINRA should take this opportunity to be on the forefront of rulemaking to strip the cloak away from the high-stakes, opaque and destabilizing swap market. As of June 2010, the swap market constituted nearly two-thirds of the $583 trillion over-the-counter derivatives market[1]. In a market short on regulation, FINRA should use this opportunity to protect the investing public. The swap market played a role in the financial crisis and impacted both retail and institutional investors. Several income mutual funds became enamored with the higher returns derivatives and swaps provided, paying little or no attention to the speculative risk taken. The damage caused by these funds, and the swaps and derivatives they invested in, provides FINRA with all the reason it should need to supervise this complex market. PIABA hopes FINRA will reconsider and conclude that an exemption for this portion of the market should not exist in the proposed rule.

PIABA supports FINRA in opposing the exclusion from the rule of research related to sales to only institutional investors which FINRA has recognized left a large hole in the information marketplace.

PIABA is supportive of FINRA's effort and remains hopeful that FINRA will better serve investors by closing the loophole provided to municipal securities and swaps. We appreciate the opportunity to comment on the process.

Very truly yours,



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[1] *See* Pravin Rao and Assad Clark: "Securities & Commodities Regulation, Changing Landscape of Swap Regulation", Vol. 44, No. 8, April 20, 2011.

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April 5, 2012

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Dear Ms. Asquith:

Thank you for the opportunity to comment on a proposed rule regarding debt research reports, which was outlined in Regulatory Notice 12-09. Wulff, Hansen & Co. is a registered broker/dealer and FINRA member. The writer currently serves on FINRA's Small Firm Advisory Board but the views and comments expressed herein are those of the firm and do not necessarily reflect those of the SFAB.

We believe that the proposed Rule is redundant and unnecessary. It attempts to address practices which are already prohibited under the securities laws and a number of current FINRA and SEC rules and regulations. It also includes many new prohibitions, which are a solution in search of a problem: The debt markets are not the equity markets, and research is not produced or used in the same way.

In justifying the proposal, FINRA cites a number of egregious abuses which have occurred in the past. Anyone who doubts that such practices are already prohibited need look only at the scores of disciplinary actions and settlements which have resulted from the cited conduct. If the conduct were not prohibited under the current regime, it seems unlikely that the millions of dollars in fines and other sanctions could have been imposed.

That said, if a new rule must be made, it should be reasonable, balanced, and should reflect the realities of the fixed-income marketplace. It should not impair the ability of firms, whether large or small, to serve their investor and issuer clients by providing services (e.g., color and commentary) which are desired by those constituencies. It should not impair the ability of firms to use their most well-informed staff when applying the suitability rules. The current proposal fails all of these tests.

Many comments were made on earlier versions of this proposal. We agree with a number of them, but would like to associate ourselves particularly with the letter dated April 29, 2011 from DA Davidson, Merriman Capital, and ThinkEquity LLC in response to Regulatory Notice 11-11. Their letter expresses our own position on many of the issues raised by the proposal.

The remainder of this letter will address only certain issues pertaining to small firms, which FINRA defines as those with fewer than 150 registered persons. Many of those firms have fewer than ten such persons.

Small Firms

The proposal contains a limited exemption from a few of its provisions for firms doing a minimal amount of investment banking business. The exemption is a step in the right direction but as written will likely have the presumably unintended consequence of prohibiting many small firms from producing anything which meets the over-broad definition of 'debt research', and as a consequence make it impossible for them to serve their customers properly. Further, to the extent firms were forced to limit their activities in order to retain the exemption, it would complicate and perhaps doom the efforts made by many issuers and institutional investors to act in a socially responsible way by supporting small firms meeting various criteria.

Specifically, the criteria for the exemption are set too low, and the proposal fails to fully address the fact that many, probably most, small firms are not in a position to segregate responsibilities to the extent required by the proposed Rule even where the exemption can be used.

Transaction Threshold

With regard to the number of transactions allowed before the exemption is lost, it fails to recognize that many small firms participate in underwriting groups formed by much larger firms. This is particularly true where issuers wish to support small firms with various characteristics (minority, gender, size, location, etc.) and request that the senior manager include such firms as co-managers. Institutional customers also support the appointment of such firms as co-managers, as their inclusion may assist the institution in meeting its own criteria with regard to doing business with such entities. While the small firm may technically be a 'co-manager', it generally has little or no influence over the terms, timing, marketing, or any other aspect of the transaction. Therefore, we suggest that any volume-based exemption be measured by transactions where the small firm acted as Sole Manager. Simply having been 'along for the ride' on someone else's deal should not influence a firm's eligibility for the exemption. The proposal also fails to reflect that some small firms may engage in many transactions that are very small, and a threshold of ten may be too low. A single $100 million transaction is surely more significant than ten $1 million transactions, but the proposal does not reflect this fact.

Revenue Threshold

In addition, we believe that the $5,000,000 threshold is much too low. We are not in a position to judge whether that is an appropriate level for the equity markets (we doubt it, since the figure in Rule 2711 includes debt transactions as well as equity), but for the debt markets we are certain it should be larger. By way of illustration, SIFMA figures indicate that total U.S. equity issuance in 2011 was $198.3 billion. A firm doing only equity business and generating $5 million in revenue from these transactions could be receiving 0.0025% of the gross transaction volume before losing the exemption. For debt securities, excluding Treasuries and municipals, 2011 issuance was $1,178 billion. Applying the same percentage of gross transactions, a small firm doing only debt business should be allowed $29.7 million in revenue from these debt transactions before losing the exemption. The fact is that debt transactions are larger

and more numerous than are equity transactions, and any volume- or revenue-based standard should reflect this fact. There are many other ways to address this issue (market share comes to mind, but we lack access to the necessary data), but it should be addressed in some manner.

Segregation and Firewalls

Even where able to meet the exemption criteria, many small firms would find it impossible to comply with the still-applicable portions of the proposed Rule. As we understand it, there is no exemption from some of the requirements that certain types of interaction, communication, and supervision among persons performing various functions be severely restricted.

In small firms, the same person often performs multiple functions. This is unavoidable. A single person may engage in both investment banking and trading. The same person may generate research for the firm's internal use or for its customers. This is an inescapable fact in the small-firm environment, particular in those where the entire spectrum of activity is performed by only a handful of people. In addition, small firms are often owned by their employees. This means that such persons will receive compensation or other financial benefit from all of these areas. FINRA has recognized these facts in the past, specifically in the 'Limited Size and Resources' exemption from certain aspects of its supervisory rules.

We urge in the strongest terms that some similar accommodation be made to reflect the fact that in small firms the same people are forced to wear multiple hats. The trader who is also a banker will inevitably talk to himself. There is no way to prevent this. Such an accommodation could include a number of safeguards designed to prevent abuse of the exemption. We would be happy to make a number of specific suggestions along those lines should FINRA accept the concept that certain barriers, whether firewalls, Chinese walls, or some other sort of walls, are not only unduly burdensome but in many cases literally impossible to construct in a small-firm environment. We believe that the limited size and resources exception in Rule 3012 has served its purpose well and have not seen any evidence that it has resulted in abuse or contravention of the purpose of the Rule. A similar exemption in the proposed Rule would allow small firms to continue to provide clients, whether investors or small issuers, with services that larger firms may be unwilling to render.

Respectfully submitted,

Chris Charles
President

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."

Ms. Marcia E. Asquith
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April 2, 2012

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

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[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).

Ms. Marcia E. Asquith
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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

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[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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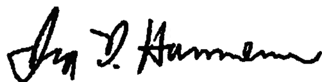
We appreciate the opportunity to comment on the Proposed Rule. We reiterate our support for many of the proposed provisions as well as our concerns with respect to others. We would be pleased to discuss any of these points further, and to provide additional information you believe would be helpful. Please 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).

BINGHAM

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April 10, 2012

Via Email

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

Re: Comments Regarding FINRA's Regulatory Notice 12-09 "Debt Research Reports"; A Proposed New FINRA Rule "Research Analysts and Debt Research Reports" and Proposed Supplemental Materials to that Proposed New FINRA Rule

Dear Ms. Asquith:

Thank you for this opportunity to comment on behalf of Morgan Stanley & Co. LLC ("Morgan Stanley" or the "Firm") on Regulatory Notice 12-09, the Proposed New FINRA Rule regarding Research Analysts and Debt Research Reports (the "Proposed Rule"), and the Proposed Supplemental Materials (together, the "Proposal"). This letter supports the Securities Industry and Financial Markets Association ("SIFMA") in each of the points made in the letter SIFMA submitted on April 2 regarding the Proposal. The intent of this letter is to expand on some of those comments as they relate to the need for further refinement of the definition of "debt research report" that FINRA incorporates in any rule that it files with the SEC for approval. Morgan Stanley believes this is prudent to avoid potential unintended restrictions on the flow of market commentary, pricing dialogue and related communications that currently take place between member firm employees other than research analysts and investors.

The Firm would like to reiterate SIFMA's recommendation that the base definition of "debt research report" incorporate the concept from both the Regulation AC definition of research report and the Rule 2711 (and Rule 472) definition for equity research report, that a research report analyzes a specific security or an issuer (Regulation AC), or analyzes the equity securities of individual companies or industries (Rule 2711). As SIFMA has recommended, the proposed definition of "debt research report" should, at a minimum, state clearly that a debt research report is "any written (including electronic) communication that includes an analysis of a debt security or an issuer..."

Furthermore, the Firm believes that the definition of "debt research report" must recognize that certain sales and trading communications with institutional clients regarding debt securities should be more clearly excluded from the current proposed definition of "debt research report" because those communications are not intended, perceived, or used by recipients as "debt research reports."

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First, the Firm recommends that FINRA add an exception to the definition of "debt research report" for those communications that are institutional sales materials that form the basis for an on-going exchange of information with institutional investors. As described below, the nature of these communications is sufficiently distinct that they should not be inadvertently captured by the definition of "debt research report" even where they may share certain characteristics with "institutional debt research reports."

Second, the Firm requests that the Proposed Rule incorporate, as recommended by SIFMA, the exception from the definition of "research report" that the SEC provided in its release adopting Regulation AC for "reports commenting on or analyzing particular types of debt securities or characteristics of debt securities."[1] The proposed definition of "debt research report" currently would incorporate the exceptions from Rule 2711 that are *derived* from the Regulation AC exceptions, but the Rule 2711 exceptions are more limited than the SEC's list in the Regulation AC release. This, presumably, is because the SEC in adopting Regulation AC had to address situations where communications might discuss equity or debt securities, while NASD and NYSE in the context of Rule 2711 and NYSE Rule 472 only had to address communications that might discuss equity securities.[2] It is very important that a rule regarding debt research reports incorporates the SEC's exceptions from Regulation AC regarding communications about debt securities, in addition to those already incorporated into Rule 2711.

The Firm's comments are premised on the regulatory framework that has been in place since 2003 and earlier for communications about debt securities. Since 2003, SEC Regulation AC has applied to all FINRA members (and other regulated research providers) that produce or distribute debt research reports, as defined in Regulation AC. And FINRA's rules regarding communications for decades have required that any communication with an institutional investor satisfy certain standards.[3]

[1] Sec. Act Rel. No. 8193, Regulation Analyst Certification (Feb. 20, 2003) http://www.sec.gov/rules/final/33-8193.htm .

[2] NASD (as it then was) and NYSE first incorporated the Regulation AC exceptions by reference in the Joint Memorandum of NASD and The New York Stock Exchange that accompanied publication of NASD Notice to Members 02-39 and NYSE Information Memorandum 02-26, but did not include the exception for "reports commenting on or analyzing particular types of debt securities or characteristics of debt securities." This exception also was not included when the exceptions were later incorporated into NASD Rule 2711 and NYSE Rule 472, presumably because these rules only reference research reports on equity securities. See NASD Notice to Member 07-04 and NYSE Information Memorandum 07-11.

[3] These have been reiterated recently in Regulatory Notice 09-55, proposing consolidated rules regarding Communications, and in FINRA's subsequent filings with the SEC in connection with these consolidated rules. We note that FINRA's consolidated rules on Communications have been approved by the SEC but the effective date is not yet announced. See, Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No.

Firms such as Morgan Stanley have built compliance programs around these regulatory pillars, as well as regulatory concepts derived from FINRA Rule 2711 that have already been imported into debt research compliance programs, and these pillars have served the markets well. Changes that may be necessitated by certain aspects of FINRA's proposed revised approach to communications regarding debt securities will be unduly burdensome and costly, and could have the effect of reducing available market information to investors without commensurate public policy returns.[4]

The Firm commends FINRA for its efforts to date to understand the broad variety of communications between FINRA members and institutional investors in debt securities. Those communications contribute to the information flow and functioning of the fixed income markets in ways that are different from traditional research reports. Indeed, the Firm believes that such communications are distinguishable from research reports, by investors and firms alike, under the existing regulatory framework.[5] Furthermore, the Firm believes that institutional investors do not rely on these communications as the sole basis for investment decisions.

The Firm understands that FINRA is hesitant to grant a blanket exception that might permit content equivalent to a traditional research report to avoid the debt research rule's requirements simply based on where within a member's operations it is produced. However, the Firm believes that FINRA's current proposal lacks sufficient exclusions or

(continued from next page)

3 and Order Granting Accelerated Approval of a Proposed Rule Change, as modified by Amendments Nos. 1, 2 and 3, to Adopt FINRA Rules 2210 (Communications with the Public), 2212 (Use of Investment Companies Rankings in Retail Communications), 2213 (Requirements for the Use of Bond Mutual Fund Volatility Ratings), 2214 (Requirements for the Use of Investment Analysis Tools), 2215 (Communications with the Public Regarding Security Futures), and 2216 (Communications with the Public About Collateralized Mortgage Obligations (CMOs) in the Consolidated FINRA Rulebook, Release No. 34-66681, File No. SR-FINRA-2011-035, (March 29, 2012).

[4] Based upon the existing regulatory framework and the Guiding Principles to Promote the Integrity of Fixed Income Research (May 2004) (the "BMA Guidelines"), the Firm has developed policies and procedures with respect to market commentary and other sales and trading communications that presently are not considered research reports. The Firm believes that the compliance infrastructure that has been created around non-research communications is effective, without unduly restricting the flow of trading ideas and other security specific information between firm employees other than research analysts--particularly market-making and facilitation desks-- and interested institutional investors.

[5] The BMA Guidelines provided a guide to distinguish between trading desk communications and research that many FINRA firms used to build their compliance programs for non-research debt communications as well as debt research.

clarity to avoid potentially inadvertently capturing normal course sales and trading communications.

The Firm would welcome the opportunity to present current examples of the types of sales and trading commentary that is exchanged with institutional investors that it considers non-research communications. Generally, such communications are not viewed as targeted to an individual client (to which an exclusion in the Proposed Rule would apply). Rather, they may be provided to a large number of institutional investors, and in some cases are posted in electronic forums where those investors can access the content if and when they choose. These communications frequently make reference to one or more specific issuers, and/or specific debt securities or classes of debt securities of one or more issuers, and frequently include relative value (or yield) comparisons, pricing or market flow information, and the sales person or trader's opinion on one or more trades, or combination of trades. These communications, which are clearly marked as communications produced from a sales or trading desk, may discuss specific debt securities in depth and in detail but, the Firm believes, are generally understood and expected by institutional market participants to be part of broker-dealers' activities in seeking and providing liquidity.

Morgan Stanley understands and appreciates that FINRA has proposed the tiering of debt research reports in the hope that regulation of debt research reports sent to institutional investors will be sufficiently flexible to permit communications like those mentioned above to continue within the debt research rule. However, the Firm believes that the construct set forth in the Proposed Rule may not provide the flexibility we believe FINRA intended. The limitations imposed on institutional debt research could inhibit the ability of sales and trading personnel to convey information on a regular basis to institutional investors in a manner that allows ongoing dialogue relative to the instruments being traded. Without an exception from the definition of "debt research report" for these communications, a FINRA examiner reviewing email or other correspondence in hindsight might believe such communications satisfy the proposed definition of debt research report, applying a "reasonable investor" standard that is not truly applicable to how institutional investors use or understand such material (i.e., an examiner might read the materials and believe that there was information sufficient upon which to base an investment decision).[6]

[6] In addition, FINRA members' personnel routinely send out written communications, that, for lack of a better term, are "macro." These communications may emanate from a trading desk, research department or elsewhere in a firm, and discuss markets and/or economic factors generally, but as part of that discussion may identify individual debt securities, either as examples or as being particularly interesting in the context of the macro discussion, without significant detail. Such reports might similarly discuss events or trends that could impact particular markets, sectors or types of issuers, and reference some or all of those issuers and their debt securities. Without clear guidance, either in the form of an exception or interpretive guidance, such communications may be deemed debt research reports subject, at a minimum, to the restrictions applicable to institutional debt research reports.

Moreover, if these communications are defined as "debt research reports" under the Proposed Rule, additional SRO and SEC requirements likely would apply, which may make distribution of the materials impermissible without pre-review by a Series 16 or Series 24 licensed Principal. Such pre-review would require the development of substantial infrastructure that would be costly and overly burdensome, and would unnecessarily impede the timely flow of information in the debt markets. Further, the treatment of some normal course sales and trading commentary as debt research reports would raise uncertainty regarding the application of Regulation AC to these materials and the certification language that is fundamentally inapposite to such materials. The Firm believes these protections are not necessary for these communications with institutional investors and, in any event, any non-research communication must include the required prominent disclosures and comply with the existing content standards in NASD IM 2210-1, which provide ample safeguards to institutional clients.

Morgan Stanley believes the amendments to the Proposed Rule outlined earlier in this letter would serve to avoid unintended consequences and allow FINRA to maintain the controls over true research content that FINRA seeks to achieve. Morgan Stanley would welcome the opportunity to work with FINRA to develop a framework that more expressly recognizes the range of communications that discuss debt securities while preserving FINRA's policy objectives. Please do not hesitate to contact me at 202-373-6118 if you have any questions regarding the above.

Sincerely yours,

Amy Natterson Kroll

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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April 2, 2012

VIA ELECTRONIC MAIL
Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K. Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 12-09: FINRA Requests Comment on a Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports

Dear Ms. Asquith:

Bond Dealers of America (BDA) is pleased to submit this letter in response to the Financial Industry Regulatory Authority's (FINRA) solicitation of comments in connection with FINRA's proposed rule relating to debt research reports (Revised FINRA Proposal). BDA is the only DC based group representing the interests of securities dealers and banks focused on the U.S. fixed income markets. The Revised FINRA Proposal will directly impact many of our members. Accordingly, we welcome this opportunity to state our position.

In general, we are concerned with FINRA's approach to developing a rule governing debt research reports. The markets have come to accept the *Guiding Principles to Promote the Integrity of Fixed Income Research* (Guiding Principles) published by The Bond Market Association in 2004 as the accepted standards governing fixed income research. In FINRA's Regulatory Notice 11-11, which conceptually proposed a rule governing fixed income research, FINRA did not state that its concern was that the Guiding Principles were not substantively adequate but rather that FINRA's concern was that firms were failing to implement the Guiding Principles or failing to ensure that they were being followed. FINRA has failed to show what abuses have occurred that justify such a dramatic shift from the substance of the Guiding Principles when dealers and investors alike have come to accept them and find them useful.

Institutional Investor Exception. Under the March 2011 concept proposal, an institutional investor had to elect to be treated as a retail investor for purposes of the debt research rules. The Revised FINRA Proposal reverses this and requires affirmative acknowledgement, in writing, by the institutional investor that it wishes to forego treatment as a retail investor. We oppose the opt-out approach of the Revised FINRA Proposal and strongly encourage FINRA to adopt the opt-in approach described in the March 2011 concept proposal.

While we recognize the need for investor protection, the imposition of the opt-out requirement would not further such purpose. FINRA's concern regarding the level of sophistication of certain institutional investors is misplaced, as institutional investors understand

the difference between objective research and trading desk commentary and understand the kinds of inherent conflicts that can exist with research analysis generated by a dealer that is seeking to sell a position. The opt-in provision is going to require a substantial amount of paperwork and compliance efforts that are simply unnecessary and, based on what FINRA says in Regulatory Notice 12-09, does not appear to be sought after by the investors themselves.

Trading and Sales Reports. In Regulatory Notice 12-09, FINRA states that it declined to exclude trader commentary from the coverage of the Revised FINRA Proposal. However, the Guiding Principles themselves saw the need for trader commentary. We simply see no reason to essentially eliminate trader commentary from the fixed income markets as it is impossible for the trading desk itself to disseminate trader commentary and comply with the extensive restrictions contained in the Revised FINRA Proposal. Some firms place blackout requirements that prohibit their research analysts from disseminating research reports when the firm is underwriting the securities. The only kind of information that is sent to investors in these cases is trader commentary. We believe that it is important that the final rule include the limitations on trader commentary that it clearly disclose that it is written by the trading desk and not a research analyst and what that may mean for the investor. But FINRA is going to categorically eliminate an entire segment of analysis distributed to retail investors without ever showing that this existing practice is in fact harmful or abusive to anyone.

Exemption of Federal Agency Securities. The Revised FINRA Proposal would exclude U.S. Treasury Securities from its scope but would not exclude agency obligations such as obligations, participations, or other instruments of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution. The market in these agency obligations is as transparent as the market for U.S. Treasury Securities. There are no secrets in the market for agency obligations and to subject reports with analysis about that market to the substantial rules governing debt research report is unnecessary and burdensome.

Compensation. Although the Revised FINRA Proposal does state that the debt research department's budget may take into consideration the revenues and results of the firm as a whole, we believe that a similar clarification should be added with respect to the compensation of the debt research analysts. That is, although the firm may not allow compensation based on specific investment banking services or specific trading transactions, we believe that the final rule should clarify that the compensation of a debt research analyst may be based on the revenues or results of the firm as a whole.

Disclosure of Conflicts. The Revised FINRA Proposal does not contain any materiality limitation to the disclosure of conflicts. We believe that the final rule should require disclosure of "all *material* conflicts that reasonably could be expected to influence the objectivity of the debt research report...." To identify literally "all" conflicts that could influence objectivity imposes an unreasonable compliance burden on firms and lacks any usefulness to the investors. Firms should be expected only to identify those conflicts that an investor would consider important in understanding the factors that may influence the analyst. We believe that the materiality limitation would accomplish this.

Definition of Debt Research Report. Although the Revised FINRA Rule specifically excludes from the definition of debt research report the kinds of communications excepted from the definition of "research report" in NASD Rule 2711, it would be helpful to actually put those exceptions into the definition of debt research report to avoid confusion. We have encountered this confusion and we suspect FINRA will too if the exceptions are not clearly stated.

Thank you again for the opportunity to submit these comments.

Sincerely,

Michael Nicholas

Chief Executive Officer

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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April 2, 2012

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-09- Debt Research Reports

Dear Ms. Asquith:

This letter is submitted on behalf of the Alliance in Support of Independent Research in response to FINRA's request for comments regarding the above-referenced Regulatory Notice.

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research.

The leading members of the Alliance in Support of Independent Research include the following broker-dealers:

BNY ConvergEx Group, LLC
John D. Meserve, Executive Managing Director

Capital Institutional Services, Inc.
Kristi P. Wetherington, President and CEO

Knight Capital Group, Inc.
Thomas M. Merritt, Esq., Senior Managing Director and Deputy General Counsel
Kevin M. Donohue, Managing Director
Paul Wagenbach, Esq., Vice President, Assistant General Counsel

The Interstate Group Division of Morgan Keegan & Co., Inc.
Grady G. Thomas, Jr., President
Jay Thomas, Chief Operating Officer

Our members are involved in a significant portion of the arrangements under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

Application of the Proposal to Independent Third-Party Research

The Alliance's comments are primarily addressed to those aspects of the Regulatory Notice which would impact the provision of third-party debt research by FINRA members to institutional asset managers through client commission arrangements structured to comply with the safe harbor under Section 28(e) of the Securities Exchange Act of 1934. In this regard, we note that in a typical third-party client commission arrangement, at the request of an asset manager, an independent third-party research preparer delivers its research product directly to an asset manager. The "providing" broker-dealer pays the research preparer directly, leaving no opportunity or rationale for the research product to be reviewed by the broker-dealer.[1]

Regulatory Notice 12-09 recognizes that the debt research report rule should generally not apply to independent third-party research, stating:

> The revised proposal also sets out the requirements for the review and distribution of third-party research. It generally incorporates the current standards for third-party equity research, including the distinction between independent and non-independent third-party research with respect to the review and disclosure requirements. In short, a firm need not review independent third-party debt research prior to distribution and may not have to include certain otherwise applicable disclosures depending on whether the research is "distributed" or made available."[2]

Notwithstanding this language from the Regulatory Notice, the actual text of the proposed rule leaves some question as to the responsibilities of broker-dealers who make available independent third-party debt research.[3]

The requirements applicable to the distribution of third-party research reports are contained in paragraph (h)(1) through (h)(5) of the proposed rule. Paragraph (h)(3) of the proposed rule exempts third-party debt research reports from the review requirements of

[1] See, e.g., SEC Rel. No. 34-54165, 71 Fed. Reg. 41978, 41992 (July 24, 2006). According to the SEC, to satisfy the "provided by" element of Section 28(e), the broker-dealer would either be legally obligated to the research preparer to pay for the research, or would satisfy the element by: 1) paying the research preparer directly; 2) reviewing a description of the services to be paid for for red flags that indicate the services are not within Section 28(e) and agreeing with the Manager to use commissions only to pay for services within the safe harbor; 3) developing procedures so that research payments are documented and paid for promptly. *Id.* at 41994-95.

[2] Regulatory Notice 12-09, at 13.

[3] An independent third-party debt research report is a third-party research report in respect of which the person producing the report: (A) has no affiliation or business or contractual relationship with the distributing member or the member's affiliates reasonably likely to influence the content of the report; and, (B) makes content determinations without any input from the member or a member's affiliates.

(h)(1)(C).[4] Paragraph (h)(4) exempts independent debt research reports "made available" (rather than "distributed to") customers by a broker-dealer from the provisions of paragraph (h)(2)[5] and (h)(1)(B).[6] There does not, however, appear to be any exemption for independent third-party research from the requirements of paragraph (h)(1)(A) or (h)(5) of the proposed rule.

Paragraph (h)(1)(A) requires a broker-dealer who distributes independent third-party research 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." A broker-dealer who makes available independent debt research reports upon request through a client commission arrangement is not in a position to determine the reliability or objectivity of a report, nor would it necessarily have the capacity to do so, as the research report would typically be selected by the broker-dealer's institutional client and delivered directly to the client by the independent third-party author.

A similar issue is raised by paragraph (h)(5) of the proposed rule, which requires a member to "ensure that a third-party debt research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the debt research report." There are several issues with imposing this obligation on broker-dealers who provide independent third-party research upon request. First, as discussed above, such research is typically selected by, and delivered directly to, a member's institutional client, and is not subject to review by the member. Second, by definition, a member is not in a position to influence or determine the content of independent third-party research, including presumably the labeling of such research as an "independent third-party debt research report."

The Alliance therefore requests that FINRA amend paragraph (h)(4) of the proposed rule to indicate that a member who "makes available" independent debt research will not be considered to have distributed such research for purposes of paragraph (h)(1) and (h)(2) and amend paragraph (h)(3) to extend the exemption contained therein to paragraph (h)(5) in addition to paragraph (h)(1)(C).

Application of the Proposal to Institutional Investors

The Alliance notes that FINRA has proposed that many of the requirements applicable to debt research reports would not apply to reports distributed only to "institutional investors," provided that such institutions have affirmatively notified each broker-dealer in writing that they wish to forego the protection of the rule. This is a change from FINRA's original proposal, which would have automatically excluded institutional

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[4] Paragraph (h)(1)(C) requires a member to establish, maintain and enforce procedures designed to ensure that any third-party debt research report it distributes contains no untrue statement of material fact and is otherwise not false or misleading.

[5] Paragraph (h)(2) requires a member to accompany a third-party debt research report with certain disclosures.

[6] This is so because (h)(1)(B) requires a member firm to put in place procedures reasonably designed to ensure that third-party debt research reports contain the disclosures required by (h)(2). Accordingly, a member exempt from making disclosures under (h)(2) would presumably be exempt from drafting procedures to ensure that such disclosures are made.

Ms. Marcia E. Asquith
April 2, 2012
Page 4 of 4

investors from most of the provisions of the rule, unless the institutions "opted-in" to protections available to retail investors. We believe FINRA's original approach, permitting institutions to "opt-in" rather than requiring them to "opt-out" is more appropriate. The default of excluding institutions from most provisions of the debt research report rule is consistent with the general notion under U.S. securities laws and regulations (including FINRA's own suitability rule) that institutions are typically sophisticated investors who are able to independently assess investment opportunities. We also note that the "opt-out" proposal would impose an administrative burden on the back-offices of both member firms and institutions that would likely result in its rare use.

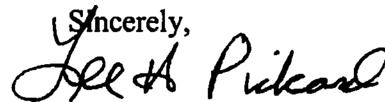
Application of the Proposal to Contacts Between Debt Research Analysts and Trading Staff

Similar to Rule 2711, FINRA's rule governing equity research reports, the debt research report rule would generally restrict contact between debt research analysts and a member's investment banking department. The Alliance supports these provisions. The proposed rule, however, goes far beyond Rule 2711 by additionally restricting many contacts between debt research analysts and a member's sales and trading personnel and principal trading personnel. It is not clear why more onerous regulatory obligations should apply to debt research reports than apply to equity research reports. The disparate application of the debt research report rule and Rule 2711 would impose administrative and compliance burdens on member firms that are not justified by any identified investor protection concerns. Accordingly, the Alliance suggests that if the debt research report proposal is adopted, its coverage be harmonized with Rule 2711.

* * *

The Alliance in Support of Independent Research appreciates the opportunity to comment on these rule changes. If you have any questions, please do not hesitate to contact Lee A. Pickard or William D. Edick at 202-223-4418.

Sincerely,



Lee A. Pickard
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March 31, 2012

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

***Re:* Comments on Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports (FINRA Regulatory Notice 12-09)**

Dear Ms. Asquith:

As a member of the Small Firm Advisory Board (any opinions expressed here are my own and not those of the Board itself) I have had the opportunity to closely monitor the progression of this proposal over the past year. I have witnessed firsthand the rulemaking process and the toil and efforts of FINRA staff to craft a rule that adequately addresses potential conflicts in Debt Research. This rule proposal is much improved from earlier iterations, and I believe that these improvements are largely attributable to FINRAs openness and consideration of comments from a variety of perspectives: member firms, industry groups and associations, and the general public. This is greatly appreciated.

However, I write today with concerns about the rule proposal and specifically its impact on FINRA member Small Firms. I believe that this rule, while well intended, is broad in its scope, at times unnecessarily complex, and as written unduly burdensome on the Small Firm. To this last point, I would argue that it is impossible for many Small Firms to comply with the rule now or at any point in the future, without some type of Small Firm exemption. However, I do think the most current proposal, which gives certain relief to members with Limited Investment Banking Activity provides an excellent starting point.

Before delving into reasons why, let me first comment that I believe the essence and intent of the rule is best captured on page 6 of Regulatory Notice 12-09. It contemplates:

> "... policies and procedures reasonably designed to promote objective and reliable research that reflects the truly held opinions of debt research analysts and prevent the use of debt research reports or debt analysts to manipulate or condition the market in favor of the interest of the firm or current or prospective customers or class of customers."

This is well written and I believe any member firm, large or small, that puts its clients first and makes protection of the public investor a priority will resoundingly agree.

It then continues in the next paragraph:

> "Those policies and procedures must limit the supervision of debt research analysts to persons not engaged in investment banking, sales and trading or principal trading activities. They further require information barriers or other institutional safeguards t o ensure debt analysts are insulated from the review, oversight or pressure from persons engaged in investment banking or principal trading activities or others who might be biased in their judgment or supervision."

This is where the rule becomes problematic, particularly for small firms. Our firm has approximately $1 billion in assets under management and twenty employees, but essentially one person wears the debt analyst/sales and trading hat and is also a member of senior management of the firm. How does one erect an information barrier in such a circumstance? Moreover, how does one construct a practical and effective barrier (and then supervise it) even when these roles are spread out amongst several people in an office of 5,000 square feet? I believe that there are many small boutique firms (perhaps in the hundreds) that are caught in this crossfire. Moreover, I also posit that many firms may not even realize so because they may mistakenly believe that the definition of "debt research" under the rule applies to selling or publishing research , not realizing the broader context of any communiqués they may have with their clients in the process of selling a bond are considered research.

In attempting to limit the interaction between debt research analysts and those outside the research department to preserve independent research, the rule becomes complex, and in my opinion at least, even overreaching. For example, the rule contemplates the determination of research budgets and compensation. While FINRA has given this topic much consideration and has further streamlined the process from prior versions, the rule prohibits certain types of compensation and permits others, calls for the formation of a committee "to annually review and approve of a debt analyst's compensation" taking into account certain named considerations, states who can (by restricting who cannot) be on the committee, AND determines who can and cannot give input in the evaluation process. I am all for truly independent research and preventing undue influence, but from a practical standpoint I've got to believe that this has even Senior Executives and Compliance Officers of Large Firm members scratching their heads. But more to the point of this comment letter, this is again problematic from the perspective of the Small Firms who can't possibly form an independent committee to review the actions of the debt research analysts and sales and trading personnel that would inevitably have to sit on it.

There are many excellent points in the rule. For example, the rule prohibits a research analyst (or a firm through its proprietary trading account) from trading in a manner inconsistent with a debt research analyst's most recently published recommendation. Again, any firm that puts its clients first would unequivocally support this position. At the beginning of the millennium we witnessed rampant abuses where firms shamelessly issued debt research reports and traded (or at the very least commented) the other way, in order to get in good standing with issuers and win subsequent investment banking relationships. If one believes as I do, that this was the very essence behind the genesis of equity research rules and now its debt research counterpart, then I believe that if a firm does no fixed income

investment banking business or some *de minimis* amount is a great starting point for a Small Firm carve out of certain aspects of the rule. FINRA's revised proposal "exempts from certain provisions regarding supervision and compensation of debt research analysts those firms that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated $5 million or less in gross investment banking revenues from those transactions." I wish to comment that this is an excellent starting point for an exemption, and while prior iterations of the rule proposal did not consider such relief (to my knowledge at any rate), it is greatly appreciated that FINRA recognizes potential burdens on Small Firms and is incorporating language into the rule to deal with such hazards. I would add however that because the impact to the Small Firm could be so burdensome, in its attempt to get the exemption right while balancing the integrity and effectiveness of the rule FINRA may wish to perform some type of impact study on small firms just over this exemption metrics implied herein, or at the very least actively identify and encourage further comment from firms on this bubble.

Regulatory Notice 12-09 is not clearly on exactly which provisions Small Firms would actually be exempted, and this must be considered moving forward. I have therefore taken the liberty of sharing a few of my own thoughts. In my opinion, at the very least the carve out should give Small Firms the relief from erecting information barriers or constraints of how compensation is determined and certain other provisions that are simply not practical from a Small Firm standpoint (and from a FINRA perspective probably difficult to enforce as such). However, I would also envision that it would not exempt Small Firms from what I call the "core" provisions of the rule (proprietary and personal trading provisions for example which are ethical standards that can be maintained regardless of firm size). Because Small Firms would not be exempted from these provisions, the public would still be protected even with this carve out. Moreover, I would argue that an additional safety net already is in place for the public, as there are already ample rules on the books (Rules of Fair Dealing, etc.) that could be enforced as a fallback position.

Thank you for the opportunity to comment on Regulatory Notice to Members 12-09.

Sincerely,

Joseph R.V. Romano
President
FINRA Small Firm Advisory Board Member

Additional Points of Comment:

1. The rule often references principal and proprietary trading, but I believe a distinction can and should be made for members at large. As an industry wide practice, many firms (in my estimation the majority of firms) run customer fixed income transactions essentially contemporaneously through their principal trading account with a reasonable markup. I think

this customary practice should be distinguished from proprietary trading where a firm seeks to profit from a change in market value of an underlying security. This latter practice is more subject to potential abuse because without disclosure clients would not know if a firm holds a position and therefore if it in so doing it conflicts with published debt research issued from the firm. On the other hand, this is not as much an issue on trades almost contemporaneously run through the principal side as firms will have a hard time selling fixed income positions run through their principal trading account to clients if they are issuing research, presumably to those same clients, which state a contra position.

2. As a further footnote, while municipal securities are not addressed in the scope and definitions in this rule presumably because they are covered by the MSRB, it is likely that the MSRB will mirror this rule on its books. Therefore, it is imperative to Small Firms that the rule gets written correctly the first time. Also, I believe anecdotally at least, that if municipal securities fall under the rule via an MSRB interpretation, the number of Small Firms affected mushrooms, as Small Firms are less likely to actively to underwrite corporate securities (a Large Firm market), but are often very active in municipal underwriting particular in the local and State arenas. This is problematic and bears great consideration.

Regulatory Notice 12-42

FINRA Requests Comment on a Revised Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports

Comment Period Expired: December 20, 2012

Executive Summary

FINRA seeks comment on a revised proposal addressing debt research conflicts of interest that includes amended exemptions for research distributed to certain institutional investors and for firms with limited principal debt trading activity. The revised proposal also includes other changes in response to comments on the prior proposal set forth in Regulatory Notice 12-09.

The text of the proposed rule can be found at www.finra.org/notices/12-42.

Questions concerning this *Notice* should be directed to:

- Philip Shaikun, Associate Vice President, Office of General Counsel (OGC), at (202) 728-8451; and
- Racquel Russell, Assistant General Counsel, OGC, at (202) 728-8363.

Due to the disruption of normal business operations relating to Hurricane Sandy, FINRA is extending the deadline to provide comment to December 20, 2012. Original deadline: December 10, 2012.

View Full Notice PDF *158 KB*

The views, expressions, findings and opinions expressed in the comments on this Web page are solely those of the author(s) and FINRA accepts no responsibility for the content of the comments.

Comments By	Date Received
CFA Institute (PDF *138 KB*)	12/7/2012
The Alliance in Support of Independent Research (PDF *327 KB*)	12/20/2012
Bond Dealers of America (PDF *318 KB*)	12/21/2012
BMO Capital Markets (PDF *842 KB*)	12/21/2012
SIFMA (PDF *887 KB*)	1/4/2013

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December 20, 2012

VIA ELECTRONIC MAIL

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K. Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 12-42: FINRA Requests Comment on a Revised Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports

Dear Ms. Asquith:

On behalf of its members, the Bond Dealers of America (BDA) is pleased to submit this letter in response to the Financial Industry Regulatory Authority's (FINRA) solicitation of comments in connection with its Regulatory Notice 12-42 in which it revised its debt research report proposal (Revised Proposal). BDA is the only DC based group representing the interests of securities dealers and banks focused on the U.S. fixed income markets. The Revised Proposal will directly impact many of our members. Accordingly, we welcome this opportunity to state our position.

While we are encouraged that the Revised Proposal incorporates several of our comments, we reiterate several of the concerns we raised in our comment letter to the original proposal.

Definition of Debt Research Report. We believe that subsection (a)(3)(C) of the proposed rule should be revised to exclude offering documents for unregistered transactions and securities. If a document is prepared by or at the request of the issuer or obligor of a security, such document should be specifically excluded from the definition of Debt Research Report under the proposed rule.

Institutional Investor Exception. While the Revised Proposal changes how institutional investors are excluded from the debt research report rules, it continues to impose a considerable burden on dealers and so it does not address our underlying concern. We believe that the debt research report rules should categorically exclude qualified institutional buyers from their scope. Qualified institutional buyers are in the business of investing and dealers should have no requirement other than ensuring that the institutional investor is in fact a qualified institutional buyer. Accordingly, we believe that FINRA should eliminate the requirements in (j)(1)(A) borrowed from FINRA Rule 2111 such as the requirement that, to be excluded, qualified institutional buyers must affirmatively indicate that they are exercising independent judgment in

evaluating the dealer's recommendations. In addition, we find it strange that a dealer may recommend a fixed income security to an "institutional account" if it follows the suitability requirements of FINRA Rule 2111 but those do not suffice for sending a debt research report to an "investment account" that is not a qualified institutional buyer. Therefore, we believe that the debt research rule should categorically exclude qualified institutional buyers and then impose requirements for other "institutional accounts" similar to the suitability standards for "institutional accounts" under Rule 2111.

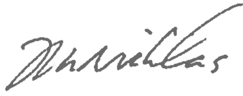
Trading and Sales Reports. As outlined in The Bond Market Association's *Guiding Principles to Promote Integrity of Fixed Income Research* (Guiding Principles), we believe that trading and sales reports should be excluded from the revised proposal as it relates to institutional investors. Trader commentary is typically specific to bonds and how they are priced. Trader commentary forms an intrinsic part of how bonds are sold and its inclusion in the debt research rules is misplaced. We do not believe that institutional investors would be confused by trader commentary or believe that it represents the work product of an independent debt research analyst. We believe that the exclusion of trading and sales reports under the Guiding Principles was appropriate as long as there was accompanying language clearly disclosing that it is trader commentary.

Exemption of Federal Agency Securities. We reiterate our concern that agency obligations should be excluded from the debt research report rules just like U.S. Treasuries are excluded. Agency obligations, such as obligations, participations, or other instruments of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution, are generally treated as U.S. Treasuries with respect to their characteristics and qualities. Further, the offer and sale of agency obligations is exempt from registration under the securities laws which evidences Congress's belief that investors in agency obligations do not have the same need of the securities laws as with non-exempt securities and we believe that same reasoning extends to research reports about agency obligations as well. As a result, the market in these agency obligations is as transparent as the market for U.S. Treasury Securities. Further, it is unlikely that dealers would have conflicts of interests with respect to agency obligations that are much different than they would with U.S. Treasuries. Accordingly, we believe that agency obligations should be excluded from the coverage of the debt research report rule.

Compensation. Although the Revised Proposal does state that the debt research department's budget may take into consideration the revenues and results of the firm as a whole, we believe that a similar clarification should be added with respect to the compensation of the debt research analysts. That is, although the firm may not allow compensation based on specific investment banking services or specific trading transactions, we believe that the final rule should clarify that the compensation of a debt research analyst may be based on the revenues or results of the firm as a whole.

Thank you again for the opportunity to submit these comments.

Sincerely,



Michael Nicholas

Chief Executive Officer

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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December 20, 2012

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-42- Debt Research

Dear Ms. Asquith:

This letter is submitted on behalf of the Alliance in Support of Independent Research in response to FINRA's request for comments regarding the above-referenced Regulatory Notice.

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research.

The leading members of the Alliance in Support of Independent Research include the following broker-dealers:

Capital Institutional Services, Inc.
Kristi P. Wetherington, President and CEO

ConvergEx Group, LLC
John D. Meserve, Executive Managing Director

Knight Capital Group, Inc.
Thomas M. Merritt, Esq., Senior Managing Director and Deputy General Counsel
Kevin M. Donohue, Managing Director
Paul Wagenbach, Esq., Vice President, Assistant General Counsel

The Interstate Group Division of Morgan Keegan & Co., Inc.
Grady G. Thomas, Jr., President
Jay Thomas, Chief Operating Officer

Our members are involved in a significant portion of the arrangements under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

Application of the Proposal to Independent Third-Party Research

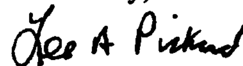
The Alliance filed a comment letter on April 2, 2012 primarily addressing the application of FINRA's prior debt research proposal (Regulatory Notice 12-09) to independent third party research.[1] As set forth in detail in the April 2, 2012 letter, the Alliance was concerned that the proposal could be read to impose obligations on FINRA members who make available independent third party debt research to establish, maintain and enforce procedures to ensure that such reports are reliable and objective and/or to ensure that such reports are labeled in a particular manner. Independent third party research distributed by a member pursuant to Section 28(e) of the Securities Exchange Act of 1934 is typically selected by the member's institutional client, and delivered directly to the institutional client by an unaffiliated research vendor, and as such it is not subject to review by the member. Furthermore, by definition, a member is not in a position to influence or determine the content of independent third party research.

The issues raised in our April 2, 2012 letter do not appear to have been addressed in Regulatory Notice 12-42. Accordingly, the Alliance respectfully requests that FINRA clarify that the provisions set forth above do not apply to members who make available independent third party debt research under Section 28(e).

* * *

The Alliance in Support of Independent Research appreciates the opportunity to comment on these rule changes. If you have any questions, please do not hesitate to contact Lee A. Pickard or William D. Edick at 202-223-4418.

Sincerely,



Lee A. Pickard
William D. Edick
Pickard and Djinis LLP
Counsel to the Alliance in Support of Independent Research

Enc.

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[1] The Alliance's April 2, 2012 letter is attached hereto and incorporated by reference to the extent the issues raised in the letter have not been addressed by Regulatory Notice 12-42.

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

C/O PICKARD AND DJINIS LLP
ATTORNEYS AT LAW
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WASHINGTON, D.C. 20036

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(202) 331-3813

April 2, 2012

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-09- Debt Research Reports

Dear Ms. Asquith:

This letter is submitted on behalf of the Alliance in Support of Independent Research in response to FINRA's request for comments regarding the above-referenced Regulatory Notice.

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research.

The leading members of the Alliance in Support of Independent Research include the following broker-dealers:

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Jay Thomas, Chief Operating Officer

Our members are involved in a significant portion of the arrangements under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

Application of the Proposal to Independent Third-Party Research

The Alliance's comments are primarily addressed to those aspects of the Regulatory Notice which would impact the provision of third-party debt research by FINRA members to institutional asset managers through client commission arrangements structured to comply with the safe harbor under Section 28(e) of the Securities Exchange Act of 1934. In this regard, we note that in a typical third-party client commission arrangement, at the request of an asset manager, an independent third-party research preparer delivers its research product directly to an asset manager. The "providing" broker-dealer pays the research preparer directly, leaving no opportunity or rationale for the research product to be reviewed by the broker-dealer.[1]

Regulatory Notice 12-09 recognizes that the debt research report rule should generally not apply to independent third-party research, stating:

> The revised proposal also sets out the requirements for the review and distribution of third-party research. It generally incorporates the current standards for third-party equity research, including the distinction between independent and non-independent third-party research with respect to the review and disclosure requirements. In short, a firm need not review independent third-party debt research prior to distribution and may not have to include certain otherwise applicable disclosures depending on whether the research is "distributed" or made available."[2]

Notwithstanding this language from the Regulatory Notice, the actual text of the proposed rule leaves some question as to the responsibilities of broker-dealers who make available independent third-party debt research.[3]

The requirements applicable to the distribution of third-party research reports are contained in paragraph (h)(1) through (h)(5) of the proposed rule. Paragraph (h)(3) of the proposed rule exempts third-party debt research reports from the review requirements of

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[1] See, e.g., SEC Rel. No. 34-54165, 71 Fed. Reg. 41978, 41992 (July 24, 2006). According to the SEC, to satisfy the "provided by" element of Section 28(e), the broker-dealer would either be legally obligated to the research preparer to pay for the research, or would satisfy the element by: 1) paying the research preparer directly; 2) reviewing a description of the services to be paid for for red flags that indicate the services are not within Section 28(e) and agreeing with the Manager to use commissions only to pay for services within the safe harbor; 3) developing procedures so that research payments are documented and paid for promptly. *Id.* at 41994-95.

[2] Regulatory Notice 12-09, at 13.

[3] An independent third-party debt research report is a third-party research report in respect of which the person producing the report: (A) has no affiliation or business or contractual relationship with the distributing member or the member's affiliates reasonably likely to influence the content of the report; and, (B) makes content determinations without any input from the member or a member's affiliates.

(h)(1)(C).[4] Paragraph (h)(4) exempts independent debt research reports "made available" (rather than "distributed to") customers by a broker-dealer from the provisions of paragraph (h)(2)[5] and (h)(1)(B).[6] There does not, however, appear to be any exemption for independent third-party research from the requirements of paragraph (h)(1)(A) or (h)(5) of the proposed rule.

Paragraph (h)(1)(A) requires a broker-dealer who distributes independent third-party research 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." A broker-dealer who makes available independent debt research reports upon request through a client commission arrangement is not in a position to determine the reliability or objectivity of a report, nor would it necessarily have the capacity to do so, as the research report would typically be selected by the broker-dealer's institutional client and delivered directly to the client by the independent third-party author.

A similar issue is raised by paragraph (h)(5) of the proposed rule, which requires a member to "ensure that a third-party debt research report is clearly labeled as such and that there is no confusion on the part of the recipient as to the person or entity that prepared the debt research report." There are several issues with imposing this obligation on broker-dealers who provide independent third-party research upon request. First, as discussed above, such research is typically selected by, and delivered directly to, a member's institutional client, and is not subject to review by the member. Second, by definition, a member is not in a position to influence or determine the content of independent third-party research, including presumably the labeling of such research as an "independent third-party debt research report."

The Alliance therefore requests that FINRA amend paragraph (h)(4) of the proposed rule to indicate that a member who "makes available" independent debt research will not be considered to have distributed such research for purposes of paragraph (h)(1) and (h)(2) and amend paragraph (h)(3) to extend the exemption contained therein to paragraph (h)(5) in addition to paragraph (h)(1)(C).

Application of the Proposal to Institutional Investors

The Alliance notes that FINRA has proposed that many of the requirements applicable to debt research reports would not apply to reports distributed only to "institutional investors," provided that such institutions have affirmatively notified each broker-dealer in writing that they wish to forego the protection of the rule. This is a change from FINRA's original proposal, which would have automatically excluded institutional

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[4] Paragraph (h)(1)(C) requires a member to establish, maintain and enforce procedures designed to ensure that any third-party debt research report it distributes contains no untrue statement of material fact and is otherwise not false or misleading.

[5] Paragraph (h)(2) requires a member to accompany a third-party debt research report with certain disclosures.

[6] This is so because (h)(1)(B) requires a member firm to put in place procedures reasonably designed to ensure that third-party debt research reports contain the disclosures required by (h)(2). Accordingly, a member exempt from making disclosures under (h)(2) would presumably be exempt from drafting procedures to ensure that such disclosures are made.

investors from most of the provisions of the rule, unless the institutions "opted-in" to protections available to retail investors. We believe FINRA's original approach, permitting institutions to "opt-in" rather than requiring them to "opt-out" is more appropriate. The default of excluding institutions from most provisions of the debt research report rule is consistent with the general notion under U.S. securities laws and regulations (including FINRA's own suitability rule) that institutions are typically sophisticated investors who are able to independently assess investment opportunities. We also note that the "opt-out" proposal would impose an administrative burden on the back-offices of both member firms and institutions that would likely result in its rare use.

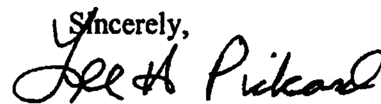
Application of the Proposal to Contacts Between Debt Research Analysts and Trading Staff

Similar to Rule 2711, FINRA's rule governing equity research reports, the debt research report rule would generally restrict contact between debt research analysts and a member's investment banking department. The Alliance supports these provisions. The proposed rule, however, goes far beyond Rule 2711 by additionally restricting many contacts between debt research analysts and a member's sales and trading personnel and principal trading personnel. It is not clear why more onerous regulatory obligations should apply to debt research reports than apply to equity research reports. The disparate application of the debt research report rule and Rule 2711 would impose administrative and compliance burdens on member firms that are not justified by any identified investor protection concerns. Accordingly, the Alliance suggests that if the debt research report proposal is adopted, its coverage be harmonized with Rule 2711.

*   *   *

The Alliance in Support of Independent Research appreciates the opportunity to comment on these rule changes. If you have any questions, please do not hesitate to contact Lee A. Pickard or William D. Edick at 202-223-4418.

Sincerely,



Lee A. Pickard
William D. Edick
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7 December 2012

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Comments on FINRA's Revised Proposal to Identify and Manage Conflicts Involving the Preparation and Distribution of Debt Research Reports (FINRA Regulatory Notice 12-42)

Dear Ms. Asquith:

CFA Institute[1] appreciates the opportunity to provide comments on FINRA's revised proposal relating to potential conflicts of interest in the preparation and distribution of debt research reports. CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

Executive Summary

CFA Institute supports efforts aimed at preventing conflicts of interest relating to the work of research analysts and the investment banking and trading sides of a firm. Untainted research must be safeguarded from undue influence that otherwise erodes market integrity and investors' trust in the system.

Exemption for "Higher-Tier" Institutional Investors

We support the proposal that would allow qualified institutional buyers that meet certain requirements to receive debt research that does not contain the disclosures required for research reports provided to retail investors. This group of institutional investors should possess the knowledge and expertise that allow them to independently evaluate the research they receive.

[1] CFA Institute is a global, not-for-profit professional association of more than 111,800 investment analysts, advisers, portfolio managers, and other investment professionals in 139 countries, of more than 104,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

Exemption for Firms with Limited Principal Debt Trading

While we are not opposed to providing exemptions in cases where the costs of compliance clearly outweigh certain risks, we are not convinced that firms with limited debt trading activities would suffer a hardship absent the proposed exemption. We would welcome additional research by FINRA on this point.

Limited Investment Banking Exemption

We generally support the proposed exemption for firms with limited investment banking activities in part because this exemption harmonizes with that currently provided in FINRA rules for equity security research.

Discussion

As a membership organization of Chartered Financial Analysts, we are keenly aware of, and strongly support efforts to manage conflicts of interest relating to the preparation and issuance of research reports. Investors deserve to receive research reports that are not compromised by other interests or influence exerted by the investment banking or trading sides of an organization. Moreover, analysts themselves should not be unduly pressured by other arms of an organization to tailor research reports or to otherwise have their compensation linked to activities outside those related to research. As importantly, the marketplace must be able to trust the impartiality of the analysts and the integrity of the report in order to invest with confidence.

We generally support the proposed requirements aimed at identifying and managing the conflicts of interest that may arise between the research arm of a company and its investment banking business. This revised proposal, drawing close parallels to rules governing equity research, goes to the heart of the issues involved in pressures that threaten to undermine the independence and objectivity of analyst research.

We strongly support FINRA's initiatives to strengthen the ability of research analysts to provide unbiased and sound research reports and recommendations without undue influence from their employers or the companies they cover in the equity securities market. We appreciate FINRA's creation of the current rules that govern research for equity securities. We now support efforts through this proposal to extend these safeguards to debt research analysts.

Institutional Investor Exemption

A prior proposal issued by FINRA required institutional investors to affirmatively "opt-in" by requiring them to provide written notice that they wished to receive debt research reports without the accompanying disclosures and other protections afforded retail investors. This revised proposal recognizes that this opt-in requirement not only is tedious but also unnecessary in some circumstances.

Specifically, in order to address this issue, this proposal creates a "higher tier" of institutional investors that would be allowed to receive the research reports by way of "negative consent," meaning that the investor simply does not indicate to the firm that it wants to be treated as a

retail investor. In order to claim this exemption, an investor in this tier must qualify as a "qualified institutional buyer" (QIB) as defined under Rule 144A and satisfy new institutional suitability standards under FINRA Rule 2111 requiring that (a) the research provider has a reasonable basis to believe the investor is capable of evaluating the risks independently, and (b) the investor confirms it is exercising independent judgment in evaluating the firm's recommendations.

We support this approach. A QIB that qualifies under Rule 144A presumably has the capability and sophistication to evaluate the research involving debt securities without the disclosures and other protections that accompany reports provided retail investors. We also support retaining a requirement that institutional investors that do not fall within the higher tier category still be allowed to receive the research without the retail investor protections but only if they notify the provider firm in writing of this election.

Limited Principal Debt Trading Exemption

Unlike FINRA's earlier proposal, this proposal would provide an exemption for firms with limited principal debt trading activity from the requirement to separate research analysts from those engaged in sales and trading and principal trading activities with respect to (a) pre-publication review of debt research, (b) supervision and compensation of the research analysts, and (c) research budget determinations. FINRA notes that in proposing this exemption, it considered the ability of smaller firms and its limited personnel to effectively create the separations between research and trading activities, as well as a trading revenue threshold that most likely minimizes the types of conflicts that arise between these two arms. In order to qualify for the exemption, a firm must (1) have gains or losses (in absolute value) of less than $15 million derived from principal debt trading on average over the previous three years; and (2) have fewer than 10 debt traders.

In offering this exemption, FINRA conducted research on smaller firms' activities, including breakdowns on categories of debt trading, whether their traders wrote research and the firms' ability to structurally separate debt research analysts from others. FINRA's research also indicated that firms with fewer than 10 debt traders typically do not dedicate a trader to writing research.

What is not clear from FINRA's description of its research is whether separation requirements would impose a hardship on the firm that would substantially outweigh separation requirements. Without clear evidence that separation impairs the ability of a large number of firms of this size to create quality debt research, we cannot support such an exemption. The evidence with regard to the negative effects of conflicted interests, on the other hand, is significant and clear. Without separation, such research is subject to influences that could compromise the independence and accuracy of the analysis and opinions provided. Moreover, the potential for traders to act on the research prior to its publication and distribution is an unacceptable outcome, regardless of the size of a firm's trading desk.

We suggest, therefore, that FINRA closely review the records it is requiring of firms that claim the exemption to keep for three years with respect to communications that otherwise would be subject to pre-publication review. Close review of these records may determine whether this exemption is warranted or subject to abuse.

Limited Investment Banking Exemption

This proposal tracks existing FINRA equity security research rules by maintaining an exemption for firms that have limited investment banking activity. Under the exemption, firms would not be required to separate research analysts from investment banking personnel with respect to (a) pre-publications review of the research, (b) supervision and compensation of research analysts, and (c) research budget determinations. Firms qualifying for the exemption would, during the previous three years (on average per year), have participated in 10 or fewer investment banking transactions acting as manager or co-manager and generated $5 million or less in gross investment banking revenues from the transactions.

For the same reasons noted above, we cannot support removing the separation between investment banking and research due to the potential conflicts of interest involved.

Conclusion

We appreciate FINRA's efforts to establish regulations for debt security research that are substantially consistent with those implemented for equity security research. Should you have any questions about our positions, please do not hesitate to contact Kurt N. Schacht, CFA at kurt.schacht@cfainstitute.org or 212.756.7728; or Linda L. Rittenhouse at linda.rittenhouse@cfainstitute.org or 434.951.5333.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director, Standards and
Financial Market Integrity
CFA Institute

/s/ Linda L. Rittenhouse

Linda L. Rittenhouse
Director, Capital Markets Policy
CFA Institute

BMO Capital Markets GKST Inc.
115 South LaSalle Street
37th Floor
Chicago, IL 60603

Tel.: 312 845-2000

December 20, 2012

Ms. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-42—Debt Research ("Notice")

Dear Ms. Asquith:

This comment letter on the rule proposal ("Proposal") in the Notice is submitted by BMO Capital Markets GKST Inc. ("BMOGKST"), a registered broker-dealer with the SEC and the MSRB. BMOGKST was founded in 1980 as Griffin, Kubik, Stephens & Thompson, Inc. It initially specialized in the underwriting and distribution of tax-exempt municipal bonds, almost exclusively to institutional customers, most of which were small and mid-size banks. As it grew, it became involved with other types of fixed-income securities such as governments and agencies. BMOGKST has approximately 120 employees, most of whom are engaged in sales and trading activities. It has a public finance group as well as relatively small credit analytics and strategic analytics groups. It is the activities of the latter group which have prompted the writing of this comment letter.

In 2008, BMOGKST was acquired by BMO Financial Group, and it continues post-acquisition to cater to institutional customers, a large percentage of which are still small and mid-size banks and what are known as Tier II and Tier III institutions. BMOGKST believes that it has a major niche in the coverage of that market. As will be described below, the ability to distribute trader commentary to those clients is of utmost importance to BMOGKST, its clients and the functioning of the debt markets in general.

While we support fully the objectives of the Proposal, we believe that even after FINRA's revision of the Proposal, it continues to impose undue burdens and obstacles upon the ability of smaller firms such as BMOGKST to provide trader commentary to Institutional Investors which are not Qualified Institutional Buyers, as we explain below.

The BMOGKST strategic analytics group exists for one purpose only—to support the Firm's sales activities to its institutional customers. The group produces trader commentary on a weekly, monthly and periodic basis, the objective of which is to relay to institutional clients the direction of the fixed-income markets and the relative value of various highly-rated, deeply liquid categories of fixed-income investments, such as municipals, treasuries, agencies,

mortgage-backeds and other asset-backed securities. The group performs no fundamental research of any kind and does not comment on nor otherwise participate in anything related to the corporate bond market. Given the size and scope of BMOGKST's business generally and that of the strategic analytics group in particular, the types of segregated management provisions proposed for debt research by the Proposal would be a tremendous burden and would place BMOGKST at a competitive disadvantage in providing trader commentary as a service to small and mid-size institutions. We believe that there is no need for new regulation of "trader commentary", but any regulation of trader commentary should be the subject of a more in depth assessment of the costs and benefits than is evident in the Notice or the Proposal.

Two of our specific concerns are that:

1. Institutional distribution of trader commentary should be exempt, subject to the ability to opt out of the exemption.
2. Any restriction of the participation of persons engaged in sales and trading or principal trading activities in the management of research personnel should clarify the distinction between sales and trading in general and those truly engaged in proprietary trading activities.

We elaborate on our thoughts below.

First, the proposed definition of "debt research report" should not include the type of activity engaged in by the strategic analytics group of BMOGKST because there is no potential for manipulating the debt markets by publishing commentary on what is happening in those markets based on a relative value analysis of the most liquid, credit-risk-free instruments in all of the securities markets. Price movements in debt securities are limited by par value, maturity and interest rate parameters. Unlike equity markets, there are top and bottom limits that cannot be exceeded (except in the case of major credit issues, which are not a factor in the types of securities that we are dealing with). The markets, and the types of securities involved, are too deep and too liquid to be moved by any one firm's commentary as to the relative value of highly rated debt issuers which do not have credit issues.

Second, we believe that the Proposal should be limited to fundamental research, as opposed to trader commentary relating to interest-rate movements demonstrated by market forces for highly-rated and extremely liquid securities. We would be pleased to provide to FINRA amendments to the Proposal which would clarify this distinction.

We note that FINRA has stated that it will undertake cost-benefit analyses of its rules. The impact of the Proposal on trader commentary deserves further rigorous cost-benefit analysis, because we apprehend that the restructuring, inefficiencies and compliance costs to members would overshadow any benefits to the public. Trader commentary is already subject to extensive rules, regulations and safeguards, including reviews by supervisors, legal and compliance

personnel and ultimately by regulators in their periodic examinations. This present mechanism is a more cost-effective manner to protect the public than the forced management restructuring and the ongoing compliance costs that would be associated with such a requirement.

We do support the Proposal's exemption for institutional recipients. We believe, however, that a less cumbersome procedure is necessary to preserve and protect the interests of the smaller and mid-size institutional clients. An affirmative consent provision is cumbersome and burdensome. We cover thousands of such clients. In most cases they have been receiving this type of commentary for years. They will be adequately protected by having the ability to notify us that they did not want to receive our commentary. In that regard, our experience with obtaining Rule 2111 institutional suitability certificates is that clients sometimes do not return the paperwork (in particular duplicate paperwork as they do not understand the need, for example, to produce different certificates for different situations, such as QIB qualification, compliance with Rule 2111 and, if this proposal is adopted, institutional consent to receive trader commentary) especially when they have been doing business with us for so many years.

We also would like to make one particular point with respect to the supposed distinction between "principal trading activities" and "sales and trading" in section (b) (3) (A) (ii) and (iii) of the Proposal in the context of a restriction on compensation decisions. Firms, such as ours, which participate in the underwriting and distribution of fixed-income securities, do so entirely on a principal basis. All of such activity is in the form of inventory management in order to sell such securities to customers. We do not trade for our own account and therefore do not have principal trading activities, but our trading personnel do position securities in the course of selling them to customers. We urge FINRA to clarify that such personnel are not deemed to be engaged in "principal trading activities".

Thank you for the opportunity to comment. If it would be helpful, we would be pleased to supply you with the type of commentary we have supplied to institutional clients for many years.

Very truly yours,

Robert J. Stracks
Counsel

RJS/ays

January 4, 2013

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 on FINRA's Proposed Rule Regarding Conflicts Involving the Preparation & Distribution of Debt Research Reports (FINRA Regulatory Notice 12-42)

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter to the Financial Industry Regulatory Authority, Inc. ("FINRA") in response to FINRA's request for comments regarding its proposal to promulgate wide-ranging rules applicable to the publication and distribution of debt research reports (the "Proposed Rule").[2] SIFMA welcomes the opportunity to respond to FINRA's Proposed Rule.

I. INTRODUCTION

SIFMA appreciates FINRA's extensive efforts to obtain input from firms regarding debt research and the role that debt research analysts play in the fixed income markets. Many of the revisions included in Regulatory Notice 12-42 (and the accompanying rule text) respond to prior industry comments and appear to be carefully tailored to take into consideration the key differences between the debt and equity markets and the unique nature of debt research. In particular, we sincerely appreciate FINRA's willingness to amend its rule to be consistent with the definitions in SEC Regulation AC[3] and its recognition that certain institutions are sophisticated and capable of making investment decisions based on research provided by broker-dealers. FINRA's changes to its original

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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.

[2] *See generally* FINRA Regulatory Notice 12-42 and the accompanying proposed rule text.

[3] SIFMA notes that there continue to be several small grammatical variations between Regulation AC and its exclusions and the FINRA Proposed Rule. We understand that these are not designed to result in interpretive differences, but request that FINRA revise its Proposed Rule so that there is no misunderstanding in the future. If the grammatical variations are intentional, we request further clarification.

proposal will significantly reduce unnecessary costs and confusion among broker-dealers and their clients.

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

- Institutional Debt Research Exemption: SIFMA believes the proposed "higher tier" definition of institutional investor – *i.e.,* qualified institutional investor ("QIB") plus satisfaction of the FINRA Rule 2111 institutional suitability standard – would introduce a confusing new standard for clients and be costly to implement. It also could potentially disadvantage institutional clients who have represented that they are capable of, and are in fact, making independent investment decisions, and should therefore be capable of analyzing "institutional debt research" even though they do not satisfy the proposed two-part definition.

- Separation of Principal Trading from Research Department: SIFMA is concerned that without a precise definition of "principal trading," the term could be read to encompass virtually all fixed income trading operations, given that the fixed income market operates primarily on a principal trading basis. If the term is meant to be read this broadly, the prohibitions in the Proposed Rule on considering revenue derived from, and input from personnel involved in, a firm's principal trading operations when making research department budgetary, evaluation and compensation decisions would likely create an imbalance between research resources and the needs of clients. This separation would largely eliminate effective client feedback on the performance of a firm's research department and research analysts.

- Additional Comments – Road Show Prohibition: Based on equity research standards, FINRA proposes to prohibit debt research analyst participation in road shows related to an investment banking services transaction. Importing this provision to debt research does not take into consideration key differences between equity and debt operations and potential unintended negative effects.

We believe the proposed modifications discussed in this comment letter are critical to preserve undisrupted access by clients to debt research and to allow research management to make well-informed decisions regarding firms' and clients' research needs. We also believe the Proposed Rule, as currently structured, will impose undue costs and burdens on the industry. Given the many other safeguards already built into the Proposed Rule, we believe the changes discussed in this comment letter will more appropriately balance the important goals of investor protection and integrity of research with the costs and burdens of the rule.

II. PROPOSED INSTITUTIONAL EXEMPTION

A. Summary of the FINRA Proposal

FINRA is proposing a higher tier of institutional investors that would be able to receive "institutional debt research" if a firm meets certain conditions under the Proposed Rule.[4] The higher tier exemption would be available to an institutional investor that (i) meets the definition of QIB and (ii) satisfies the new FINRA Rule 2111 institutional suitability standards that require that (a) a firm has a reasonable basis to believe that the institutional investor is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a "debt security" or "debt securities," as defined in the Proposed Rule; and (b) the institutional investor has affirmatively indicated that it is exercising independent judgment in evaluating the firm's recommendations pursuant to the suitability rule, provided such affirmation generally covers transactions in debt securities ("Proposed Exemption").

B. Concerns with the Proposed Exemption

SIFMA appreciates FINRA's recognition that a category of institutions is sophisticated and capable of both assessing its own investment needs and making investment decisions based on research provided by broker-dealers. We are also grateful for FINRA's willingness to address the industry's concern that the recent proliferation of regulatory requirements to obtain client representations (*e.g.*, FINRA Rule 2111, the Dodd-Frank Act) has created compliance and systems challenges and placed significant constraints on firm resources. Coming close in time, but in an uncoordinated fashion, these various requirements also have the potential to confuse clients.

Although basing the Proposed Exemption on two existing certifications may appear at first glance to address these concerns, in fact it raises more problems than it solves. As discussed below, we believe the Proposed Exemption is impractical in many respects, creates a confusing new standard for clients, and potentially disadvantages institutional clients who have represented that they are capable of, and are in fact, making independent investment decisions, and who should therefore be capable of analyzing institutional debt research even though they do not satisfy the proposed two-part definition.

i. Incompatible Standards

As you are aware, FINRA member firms have recently implemented processes to satisfy the institutional suitability requirements under FINRA Rule 2111, which included obtaining from institutional clients an affirmative indication (for these purposes referred to as "Suitability Certifications") that the client is exercising independent judgment in evaluating recommendations. These Suitability Certifications are obtained from clients and tracked in firm systems at the relationship, or order placer, level. In contrast, QIB Certificates designed to address SEC Rule 144A are tracked for specific transactions, largely at the underlying account level. This reflects the different purposes of FINRA Rule 2111 and SEC Rule 144A – FINRA Rule 2111 was primarily designed to clarify client relationships with broker-dealers, while SEC Rule 144A was primarily designed to address eligibility for particular transactions.

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[4] *See* FINRA Regulatory Notice 12-42 at p.3.

Joining these two disparate standards would create anomalous results. For example, registered investment advisers who have completed a Suitability Certification may have multiple large underlying accounts – half of which have participated in a SEC Rule 144A transaction and thus have signed a QIB Certificate, and half of which have not. Under the Proposed Exemption, the registered investment adviser would be able to use institutional debt research for half of its accounts under management, but not the other half. Not only would this result in the inequitable treatment of similarly situated accounts, it would be extremely difficult to monitor or enforce, particularly because the registered investment adviser has a duty to use pertinent information to the benefit of all its advised accounts. The Proposed Exemption could also result in a situation where a client of a firm that has signed a QIB Certificate (representing that it is sophisticated and well capitalized) transacts in restricted securities with the firm, while unable to receive research on any debt instrument, including restricted securities, without taking additional steps.

In addition, under the Proposed Exemption, registered broker-dealers could potentially be precluded from obtaining institutional debt research. Specifically, because registered broker-dealers are not "customers," they do not make an affirmative acknowledgment under FINRA Rule 2111. In addition, under SEC Rule 144A,[5] unless acting in a riskless principal basis, only certain broker-dealers qualify as QIBs.[6] Because firms are unable to identify the specific size of broker-dealer counterparties at the relationship level (as opposed to individual transactions), this standard effectively could deny these broker-dealer counterparties access to institutional research – a result that would serve no investor protection goals.

ii. Costly to Implement

Mapping QIB Certificates to Suitability Certifications (or equivalent documentation) would also be an extensive and costly exercise for the industry. At large firms, the systems that maintain these documents are typically not linked and the client naming conventions in these systems often differ. Furthermore, the systems that maintain these documents are usually different from the systems that maintain firms' research distribution lists. The systems that maintain research distribution lists maintain individual contacts at institutional clients in addition to the institutional client's legal entity information. Individual contacts may be associated with one or more affiliated legal entities, and the naming convention for those entities likely differs from the naming conventions in firms' QIB and Suitability Certification systems. Consequently, any effort to map QIB Certificates to Suitability Certifications, and in turn to map the result to a firm's research distribution list by legal entity, would be a complex matching exercise requiring manual research on each client, standardization of naming conventions, and technology builds to link the various systems. Because the industry has a wide range of systems challenges, it is difficult to estimate the average cost of implementation of the Proposed Exemption. Implementation costs, however, are likely to be high and may reach as much as $5 million, as estimated by one large firm.

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[5] *See* 17 C.F.R. § 230.144A.

[6] Broker-dealers that in the aggregate own and invest on a discretionary basis at least $10 million of securities of issuers that are not affiliated with the dealer are eligible to sign a QIB Certificate.

Moreover, because the universe of QIB Certificates does not mirror the universe of Suitability Certifications on file, firms ultimately may be forced to develop yet another certification specific to debt research. Finally, conducting this costly data mapping exercise and implementing related systems changes is not necessary to protect investors who have already indicated their sophistication by stating that they exercise independent judgment in evaluating investment decisions. Rather, such measures would create unnecessary confusion and potentially prevent certain sophisticated institutions from obtaining institutional debt research, as firms may be forced to conclude that the costs of relying on the Proposed Exemption are not worth the benefits.

C. Suggested Alternative Approach

i. Primary Option – FINRA Suitability Rule

In sum, SIFMA is concerned that the Proposed Exemption is impractical in many respects and may disadvantage institutional investors. For these reasons, for *non-natural person* clients, SIFMA continues to believe that the institutional exemption should be based on FINRA Rule 2111. FINRA should recognize that clients who have affirmatively indicated that they are capable of, and are in fact, exercising independent judgment with respect to recommended securities transactions also are capable of evaluating, and indeed wish to receive, institutional debt research.

ii. Alternative Option – Sophistication of Order Placer

Any alternate approach should look to a standard based on the sophistication of the order placer, rather than relying on the combination of two different standards that were developed for other purposes. Specifically, if FINRA chooses not to base the institutional exemption on FINRA Rule 2111, we strongly recommend that it apply the exemption at the order placer, rather than the account, level. If the suitability analysis is appropriate for recommendations at the order placer level, it follows that this level should be appropriate for an even less personalized form of communication like a research report. Otherwise, a client who is an institutional client of a firm for purposes of FINRA Rule 2111 may not be permitted to use the institutional debt research produced by that firm to make decisions about orders for its underlying accounts.

SIFMA recognizes FINRA's concerns that not all order placers should be treated as institutions, and submits that the following institutions are sophisticated and fully capable of receiving institutional research, as they do today:

- Institutions with $100 million in assets or institutions that in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity (*i.e.,* QIBs);
- Registered broker-dealers and banks, savings and loan associations, insurance companies and registered investment companies;
- Investment advisers registered either with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions);
- Institutions with $50-$100 million in assets, ***provided*** they are represented by an independent investment adviser; and

- Institutions, such as universities, regulatory and government entities, that use research for a non-investment (*e.g.*, academic) purpose.

As under FINRA Rule 2111, firms should be required to demonstrate compliance with the above standard, but have the flexibility to choose the form of documentation that best serves their client needs.

This alternative proposal is similar to FINRA Rule 4512(c), with three important caveats. First, natural persons would not be included in the exemption. Second, firms would need to evidence that institutions with $50-$100 million in assets are represented by an independent investment adviser. As a result, in order to receive institutional debt research, smaller institutions like municipalities and charitable organizations, for example, would need to be represented by an independent third party charged with analyzing the institutional debt research on their behalf. Third, the proposal would recognize the academic benefits of institutional debt research.

Even though it would still take time for firms to implement this alternative criteria, firms could more readily adapt existing systems built for FINRA Rule 2111. More important, many sophisticated institutional clients who receive institutional research today could continue to receive that research without disruption. As the Proposed Rule indicates, any institutional investor that prefers to receive only those debt research reports that are eligible to be provided to retail investors would still be able to "opt in" to retail research.

III. SEPARATION OF PRINCIPAL TRADING FROM RESEARCH DEPARTMENT – RESEARCH BUDGET & EVALUATION/COMPENSATION

A. Summary of the FINRA Proposal

Except as otherwise provided in the Proposed Rule, FINRA is proposing to prohibit consideration of revenue and input from a firm's principal trading operations into various aspects of the operations of a firm's research department, including research department budgetary and evaluation/compensation decisions, and prohibit the consideration of contributions to a member's principal trading activities in determining analyst compensation.

B. Concerns with the FINRA Proposal

SIFMA has concerns about three specific provisions in the Proposed Rule as it relates to research for which the institutional exemption is not applicable. In particular, we are concerned about Section (b)(3)(B) of the Proposed Rule which would prohibit consideration of revenues derived from principal trading activities in determining the budget for research, Section (b)(3)(C) which would prohibit the consideration of contributions to a member's principal trading activities in compensating debt research analysts, and Section (b)(3)(D) which would prohibit the consideration of input from personnel engaged in principal trading activities in evaluating debt research analysts.

i. Research Budgetary Considerations

Firm research departments are not revenue generating businesses, nor do they have unlimited resources to allocate to cover issuers and debt products. Instead, their operations depend upon the Firm's allocation of adequate funds to meet their resourcing requirements. As part of establishing a Research department's budget, senior management needs to understand not only the demand for resources, but also the corresponding size of the expected business, both overall as well as at the asset class level. Given that sales and trading revenue cannot be practically segregated, the Proposed Rule would prohibit research management from considering the revenue from both sales/trading and investment banking - the primary sources of funding of research. SIFMA is not challenging the inability to consider investment banking revenue given this is consistent with the FINRA equity research rule. However, when this restriction is coupled with the inability to consider sales/trading revenue, it would virtually prohibit research management from considering revenue altogether in making research budget decisions.

The Proposed Rule recognizes the importance of allowing sales and trading personnel to provide input regarding the "demand for and quality of debt research, including product trends and client interests." However, by prohibiting the consideration of this revenue against those demands for resources, the Proposed Rule eliminates any ability of research management to assess the legitimacy of that input. The allocation of the research department's resources to a particular asset class (*e.g.* mortgage research, high yield research) will be and should be influenced by the size and profitability of the respective market. Eliminating the consideration of sales and trading revenue from the research department budget determination will cripple research and Firm management's ability to align research resources with client demands. Decisions would be based only on expressed client needs and demands, without the ability to consider whether there is actually a volume of market and client interest sufficient to buttress such demands.

Furthermore, we do not believe that the potential harm to the research budget decision process that could result from the Proposed Rule is outweighed by the potential benefit. In our view, we find it challenging to construct a scenario in which a budget decision, which is made by senior management with respect to the overall department, could inappropriately influence the content of research, particularly given the other safeguards in the Proposed Rule, which SIFMA firmly supports.

ii. Research Evaluation and Compensation Considerations

a. <u>In General</u>

Research management currently relies on input from sales and trading to assist them in evaluating whether analysts' research reports and services are valued by clients. Determining the performance of fixed income analysts and their recommendations is more complex than in the equity markets. For example, there are limited buy-side surveys providing input on fixed income research analysts, and many of these surveys relate to analyst teams and not individual performers. In addition, unlike equity research, where research management can objectively measure the accuracy of an analyst's price targets and estimates, it is challenging to objectively ascertain the performance of debt research analysts' recommendations, even when fixed income securities are rated, which is not always the case.

Although SIFMA appreciates that the Proposed Rule would permit sales personnel to provide input to research management in order to convey client feedback and also would permit consideration of contributions to a member's sales activities, personnel engaged in principal trading activities would be specifically prohibited from providing the same type of input. As mentioned above, SIFMA's key concern is with the reference to "principal trading" given that the fixed income markets operate primarily on a principal basis. If principal trading as used in the Proposed Rule is meant to encompass virtually all trading activities, we are concerned about the broad impact this will have on research management's ability to appropriately evaluate and compensate fixed income research analysts.

Fixed income traders have significant interaction with a firm's clients, and in many situations clients interact with traders to the exclusion of a firm's sales team. Clients will often request meetings with debt research analysts and traders in order to obtain an overview of a particular issuer or sector from the analyst and of the market from the trader. When the client ultimately determines a course of action, they will often convey their view of the value of the research analyst's analysis directly to the trader. Prohibiting fixed income traders from conveying such input to research management, and prohibiting research management from considering such activities when determining compensation, will eliminate valuable information that is used today to help evaluate the impact and value of debt research analysts to the firm's clients.

It would be difficult for research management to find a substitute for the feedback they receive today from traders. Research management does not have the capacity to contact a sufficient number of clients to obtain informed views on individual analysts, nor is research management able to rely solely on research and sales personnel to elicit the type and quality of comments that client facing trading personnel receive on a daily basis. In any case, SIFMA believes the Proposed Rule contains sufficient provisions to mitigate potential conflicts of interest that could arise if trader input were permitted. For example, the Proposed Rule would prohibit compensation decisions from being based upon specific trading transactions. The Proposed Rule also would require that the compensation of each debt research analyst must be reviewed and approved by a committee that reports to the firm's board of directors, that such committee not include trading personnel, that each compensation determination must consider the analyst's individual performance, including the quality of the analyst's research, and that the basis for determining the compensation must be documented – all requirements that SIFMA supports and agrees will help to mitigate potential conflicts of interest.

b. Compatibility with Other Regulatory Requirements – CFTC Rules

SIFMA would like to draw FINRA Staff's attention to the recently implemented rule from the CFTC addressing conflicts of interest between derivatives research analysts and sales and trading.[7] Similar to FINRA, the CFTC was concerned with potential conflicts of interest if input from sales and trading personnel were considered in the compensation determination process for derivatives research

[7] *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, available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister022312b.pdf *(last visited Jan. 3, 2013).*

analysts. The CFTC addressed these concerns in its final rule by permitting input only to the extent it is reflective of client feedback, similar to the Proposed Rule as it relates to input from sales personnel. However, the CFTC rule did not draw a distinction between sales and trading, recognizing that many traders interact frequently with clients.[8] Given that many firms have debt research analysts who will be subject to both the FINRA debt research rule and the CFTC conflict of interest rule because of the nature of their research, it will create confusion and implementation challenges if the FINRA rule, unlike the CFTC rule, does not permit any trader feedback in evaluating debt research analysts.

C. Suggested Alternative Approach

The fixed income market is a principal trading based market, and very little trading activity is conducted on an agency basis. Unless defined more precisely, persons engaged in "principal trading" could encompass virtually all persons engaged in debt trading activities. If FINRA continues to believe that the other protections of the Proposed Rule are not sufficient to address potential conflicts, SIFMA suggests that FINRA focus on trading that is not client driven – *i.e.*, conflicts with respect to proprietary trading activities.

Accordingly, SIFMA recommends that the Proposed Rule define "principal trading" as:

- "engaging in proprietary trading activities for the trading book of a member but does not include transactions undertaken as part of underwriting related, market-making related, or hedging activities, or otherwise on behalf of clients."

IV. <u>ADDITIONAL COMMENTS – ROAD SHOW PROHIBITION</u>

A. Summary of the FINRA Proposal

FINRA proposes to prohibit debt research analyst "participation in road shows ... related to an investment banking services transaction" ("Road Show Prohibition").[9] This is the same language as NASD Rule 2711, which applies to equity research analysts. NASD (n/k/a FINRA) has interpreted this requirement to permit equity research analysts to dial into road shows from a remote location in listen-only mode and not be identified as being present ("Equity Research Analyst Interpretation").[10] SIFMA assumes that the Equity Research Analyst Interpretation also will apply to debt research analyst activities.

B. Concerns with the FINRA Proposal

Even assuming that the Equity Research Analyst Interpretation will apply to debt research analyst activities, SIFMA has concerns that applying a road show prohibition to the activities of debt research analysts does not take into consideration key differences between equity and debt research departments and potentially could result in unintended negative effects. Equity research analysts

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[8] *Id. at pp. 98 and 222.*

[9] *See* FINRA Regulatory Notices 12-42 and 12-09.

[10] *See* NASD Notice to Members 07-04.

typically cover a fixed and far more limited number of companies within a particular sector, and as a result, typically know and have ongoing professional relationships with management of issuers under coverage. Debt research analysts, on the other hand, have constant and substantial turnover of issuers under coverage. Accordingly, even though equity research analysts can only hear - but not see - a deal road show, they are otherwise familiar with issuer management and so the ability to physically view management in this context is usually not of critical importance. By contrast, the issuer coverage universe of debt research analysts is wider and more fluid.

There is, in addition, a long tradition of management making efforts to grant equity analysts the opportunity to engage in Q&A with management, interview mid-level and divisional heads, and attend investor days. No such tradition exists for debt analysts. It is also worth noting that roughly one third of high yield issuers are privately held entities and/or have been spun off from another firm (*i.e.*, previously were part of a larger organization). For such firms there is no historical track record of operating or financial performance and no prior management history.

In a deal context, the road show - typically a luncheon -- is often the only opportunity for a debt research analyst to view an issuer's management presentation. Actually seeing a management presentation is important in order to understand the nuance of the message, to follow the presentation in relation to materials that may be in the room (and may or may not be available to dial-in participants), and to evaluate the credibility of management's business plan and outlook. Unlike in the equity deal context, debt deals typically take place at a quick pace with issuers having a crowded road show calendar - often spending a single day in each city. It is, therefore, usually impractical for management to have separate in-person meetings with debt research analysts. Additionally, there are often significant challenges to dialing in remotely as often no phone line will be available, and the questions being posed by audience members cannot be heard over the phone line.

The concern is more pronounced in certain segments of the debt markets, including U.S. high-yield and emerging markets, which have seen record issuances in recent years. In particular, with respect to private companies in these markets, there may be no prior public information available and, as noted, there may be no access to management until the roadshow itself. In a deal setting, it is critical for a debt research analyst to rapidly get up to speed not just on the transaction, but on the issuer. In our view, not permitting passive attendance at the road show would unduly hamstring debt research analysts' ability to formulate robust and thoughtful insights.

C. Suggested Clarification

SIFMA is requesting that FINRA revise the proposed rule to specifically permit debt research analysts to passively attend (both remotely and in-person) deal road shows. We understand that passive attendance would not allow debt research analysts to participate in the road show presentation, sit on the dais, identify themselves as being an analyst, pose questions or otherwise make comments from the audience.

V. EFFECTIVE DATE FOR THE PROPOSED RULE

SIFMA requests that firms be provided with sufficient time to make the necessary system, policy and procedural changes to implement the final rule. Depending on the requirements of the final rule, SIFMA estimates that firms will need from 12 to 18 months after SEC approval. In addition to systems issues, large firms will be devoting considerable time and resources throughout 2013 to Dodd-Frank compliance, clients may be confused by yet another outreach effort coming so soon on the heels of FINRA 2111 and Dodd-Frank, and any changes to Research budget and compensation processes must be developed and implemented well in advance of the year-end process, which at most large firms begins in the fourth quarter.

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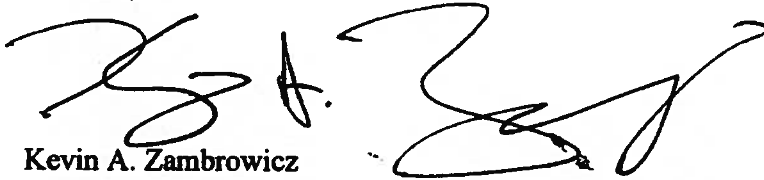
SIFMA appreciates the opportunity to comment on the Proposed Rule. SIFMA reiterates our support for many of the proposed provisions, subject to the concerns outlined above. SIFMA would be pleased to discuss any of these points further, and to provide additional information you believe would be helpful. Please feel free to contact me at (202) 962-7386, if you have any questions or comments.

Sincerely,



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