

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74340; File No. SR-FINRA-2014-048)

February 20, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports)

I. Introduction

On November 14, 2014, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule to adopt new FINRA Rule 2242 (Debt Research Analysts and Debt Research Reports) to address conflicts of interest relating to the publication and distribution of debt research reports. The proposal was published for comment in the Federal Register on November 24, 2014.<sup>3</sup> The Commission received five comments on the proposal.<sup>4</sup> This order institutes

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Exchange Act Release No. 73623 (Nov. 18, 2014); 79 FR 69905 (Nov. 24, 2014) (“Notice”). On January 6, 2015, FINRA consented to extending the time period for the Commission to either approve or disapprove the proposed rule change, or to institute proceedings to determine whether to approve or disapprove the proposed rule change, to February 20, 2015.

<sup>4</sup> See Letter from Kevin Zambrowicz, Associate General Counsel & Managing Director and Sean Davy, Managing Director, SIFMA, dated Dec. 15, 2014 (“SIFMA”), Letter from Hugh D. Berkson, President-Elect, Public Investors Arbitration Bar Association, dated Dec. 15, 2014 (“PIABA Debt”), Letter from Yoon-Young Lee, WilmerHale, dated Dec. 16, 2014 (“WilmerHale Debt”), Letter from William Beatty, President and Washington (State) Securities Administrator, North American Securities Administrators Association, Inc., dated Dec. 19, 2014 (“NASAA Debt”), and Letter from Kurt N. Schacht, CFA, Managing Director, Standards and Financial Market Integrity and Linda L. Rittenhouse, Director, Capital Markets Policy, CFA Institute, dated Feb. 9, 2015 (“CFA Institute”).

proceedings under Section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to approve or disapprove the proposed rule change.

## II. Description of the Proposed Rule Change

As described more fully in the Notice, FINRA proposed to adopt FINRA Rule 2242 to address conflicts of interest relating to the publication and distribution of debt research reports. Proposed FINRA Rule 2242 would adopt a tiered approach that FINRA believed, in general, would provide retail debt research recipients with extensive protections similar to those provided to recipients of equity research under current and proposed FINRA rules,<sup>6</sup> with modifications to reflect differences in the trading of debt securities.

As stated above, the Commission received five comments on the proposal. All of these commenters expressed general support for the proposal.

### A. Definitions

The proposed rule change would adopt defined terms for purposes of proposed FINRA Rule 2242.<sup>7</sup> Most of the defined terms closely follow the defined terms for equity research in NASD Rule 2711, as amended by the equity research filing, with minor changes to reflect their application to debt research. A summary of selected proposed definitions are set forth below.<sup>8</sup>

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<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>6</sup> See Exchange Act Release No. 73622 (Nov. 18, 2014); 79 FR 69939 (Nov. 24, 2014) (SR-FINRA-2014-047) (proposing amendments to current SRO rules relating to equity research).

<sup>7</sup> See proposed FINRA Rule 2242(a) for all of the proposed defined terms.

<sup>8</sup> See Notice for a full description of all definitions. FINRA stated that the proposed rule change also would adopt defined terms to implement the tiered structure of proposed FINRA Rule 2242, including the terms “qualified institutional buyer” or “QIB,” which is part of the description of an institutional investor for purposes of the Rule, and “retail investor.”

The proposed rule change would define the term “debt research report” as any written (including electronic) communication that includes an analysis of a debt security or an issuer of a debt security and that provides information reasonably sufficient upon which to base an investment decision, excluding communications that solely constitute an equity research report as defined in proposed Rule 2241(a)(11).<sup>9</sup> The proposed definition and exceptions noted below would generally align with the definition of “research report” in NASD Rule 2711, while incorporating aspects of the Regulation AC definition of “research report”.<sup>10</sup>

Communications that constitute statutory prospectuses that are filed as part of the registration statement would not be included in the definition of a debt research report. In general, the term debt research report also would not include a number of communications, similar to the equity proposal, if they do not include an analysis of, or recommend or rate, individual debt securities or issuers.<sup>11</sup> The term debt research report also, in general, would not include a number of communications, similar to the equity proposal, even if they include an

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<sup>9</sup> See proposed FINRA Rule 2242(a)(3). The proposed rule change does not incorporate a proposed exclusion from the equity research rule’s definition of “research report” of communications concerning open-end registered investment companies that are not listed or traded on an exchange (“mutual funds”) because it is not necessary since mutual fund securities are equity securities under Section 3(a)(11) of the Exchange Act and therefore would not be captured by the proposed definition of “debt research report” in the proposed rule change.

<sup>10</sup> In aligning the proposed definition with the Regulation AC definition of research report, the proposed definition differs in minor respects from the definition of “research report” in NASD Rule 2711. For example, the proposed definition of “debt research report” would apply to a communication that includes an analysis of a debt security or an issuer of a debt security, while the definition of “research report” in NASD Rule 2711 applies to an analysis of equity securities of individual companies or industries.

<sup>11</sup> These include, for example, discussions of broad-based indices and commentaries on economic, political, or market conditions. See Notice.

analysis of an individual debt security or issuer and information reasonably sufficient upon which to base an investment decision.<sup>12</sup>

The proposed rule change would define the term “debt security” as any “security” as defined in Section 3(a)(10) of the Exchange Act, except for any “equity security” as defined in Section 3(a)(11) of the Exchange Act, any “municipal security” as defined in Section 3(a)(29) of the Exchange Act, any “security-based swap” as defined in Section 3(a)(68) of the Exchange Act, and any “U.S. Treasury Security” as defined in paragraph (p) of FINRA Rule 6710.<sup>13</sup> The proposed definition excludes municipal securities, in part because of FINRA’s jurisdictional limitations with respect to such securities. The proposed definition excludes security-based swaps given the nascent and evolving nature of security-based swap regulation.<sup>14</sup> However,

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<sup>12</sup> These include statistical summaries of multiple companies’ financial data, including listings of current ratings that do not include an analysis of individual companies’ data and an analysis prepared for a specific person or a limited group of fewer than 15 persons. See Notice.

<sup>13</sup> See proposed FINRA Rule 2242(a)(4).

<sup>14</sup> The Commission’s rulemaking in the area of security-based swaps, pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), is ongoing. In June 2011, the Commission proposed rules addressing policies and procedures with respect to research and analysis for security-based swaps as part of its proposal governing business conduct standards for security-based swap dealers and major security-based swap participants. See Securities Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42396 (July 18, 2011) (Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants). In June 2012, the Commission staff sought comment on a statement of general policy for the sequencing of compliance dates for rules applicable to security-based swaps. See Securities Exchange Act Release No. 67177 (June 11, 2012), 77 FR 35625 (June 14, 2012) (Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act). In May 2013, the Commission re-opened comment on the statement of general policy and on the outstanding rulemaking releases. The comment period was reopened until July 22, 2013. See Securities Exchange Act Release No. 69491 (May 1, 2013), 78 FR 30800 (May 23,

FINRA stated it intends to monitor regulatory developments with respect to security-based swaps and may determine to later include such securities in the definition of debt security.

The proposed rule change would define the term “investment banking department” as any department or division, whether or not identified as such, that performs any investment banking service on behalf of a member.<sup>15</sup> The term “investment banking services” would include, without limitation, acting as an underwriter, participating in a selling group in an offering for the issuer or otherwise acting in furtherance of a public offering of the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital or equity lines of credit or serving as placement agent for the issuer or otherwise acting in furtherance of a private offering of the issuer.<sup>16</sup>

Under the proposed rule change the term “qualified institutional buyer” would have the same meaning as under Rule 144A of the Securities Act.<sup>17</sup>

The proposed rule change would define “research department” as any department or division, whether or not identified as such, that is principally responsible for preparing the substance of a debt research report on behalf of a member.<sup>18</sup> The proposed rule change would

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2013) (Reopening of Comment Periods for Certain Proposed Rulemaking Releases and Policy Statements Applicable to Security-Based Swaps).

<sup>15</sup> See proposed FINRA Rule 2242(a)(8).

<sup>16</sup> See proposed FINRA Rule 2242(a)(9). The current definition in NASD Rule 2711 includes, without limitation, many common types of investment banking services. The proposed rule change and the equity research filing propose to add the language “or otherwise acting in furtherance of” either a public or private offering to further emphasize that the term “investment banking services” is meant to be construed broadly.

<sup>17</sup> See proposed FINRA Rule 2242(a)(12).

<sup>18</sup> See proposed FINRA Rule 2242(a)(14).

define the term “subject company” as the company whose debt securities are the subject of a debt research report or a public appearance.<sup>19</sup> Finally, the proposed rule change would define the term “third-party debt research report” as a debt research report that is produced by a person or entity other than the member.<sup>20</sup>

One commenter requested that the proposal define the term “sales and trading personnel” as “persons who are primarily responsible for performing sales and trading activities, or exercising direct supervisory authority over such persons.”<sup>21</sup> The commenter’s proposed definition is intended to clarify that the proposed restrictions on sales and trading personnel activities should not extend to: (1) senior management who do not directly supervise those activities but have a reporting line from such personnel; or (2) persons who occasionally function in a sales and trading capacity.

One commenter asked FINRA to include an exclusion from the definition of “debt research report” for private placement memoranda and similar offering-related documents prepared in connection with investment banking services transactions.<sup>22</sup> The commenter noted that such offering-related documents typically are prepared by investment banking personnel or non-research personnel on behalf of investment banking personnel. The commenter asserted that absent an express exception, the proposals could turn investment banking personnel into research analysts and make the rule unworkable. The commenter noted that NASD Rule 2711(a) excludes communications that constitute statutory prospectuses that are filed as part of a

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<sup>19</sup> See proposed FINRA Rule 2242(a)(15).

<sup>20</sup> See proposed FINRA Rule 2242(a)(16).

<sup>21</sup> WilmerHale Debt.

<sup>22</sup> WilmerHale Debt.

registration statement and contended that the basis for that exception should apply equally to private placement memoranda and similar offering-related documents.

One commenter suggested that FINRA revise the definition of “subject company” to specify that the term means the “issuer (rather than the “company”) whose debt securities are the subject of a debt research report or a public appearance.”<sup>23</sup> The commenter noted that, among other things, the proposal would cover debt issued by persons other than corporate entities, such as foreign sovereigns or special purpose vehicles.

B. Identifying and Managing Conflicts of Interest

Similar to the proposed equity research rules, the proposed rule change contains an overarching provision that would require members to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of debt research reports, public appearances by debt research analysts, and the interaction between debt research analysts and persons outside of the research department, including investment banking, sales and trading and principal trading personnel, subject companies and customers.<sup>24</sup> Specifically, members must implement written policies and procedures reasonably designed to promote objective and reliable debt research that reflects the truly held opinions of debt research analysts and to prevent the use of debt research reports or debt research analysts to manipulate or condition the market or favor the interests of the firm or current or prospective customers or class of customers.<sup>25</sup> The

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<sup>23</sup> WilmerHale Debt.

<sup>24</sup> See proposed FINRA Rule 2242(b)(1).

<sup>25</sup> See proposed FINRA Rule 2242(b)(2).

proposed rule change then sets forth minimum requirements for those written policies and procedures.

According to FINRA, these provisions set out the fundamental obligation for a member to establish and maintain a system to identify and mitigate conflicts to foster integrity and fairness in its debt research products and services. FINRA stated that these provisions are also intended to require firms to be more proactive in identifying and managing conflicts as new research products, affiliations and distribution methods emerge. FINRA believes this approach allows for some flexibility to manage identified conflicts, with some specified prohibitions and restrictions where disclosure does not adequately mitigate them. According to FINRA, most of the minimum requirements have been experience tested and found effective in the equity research rules.

The rule proposal thus would adopt a policies and procedures approach to identification and management of research-related conflicts of interest and require those policies and procedures to, at a minimum, prohibit or restrict particular conduct. Commenters expressed several concerns with the approach.

Two commenters asserted that the mix of a principles-based approach with prescriptive requirements was confusing in places and posed operational challenges. In particular, the commenters recommended eliminating the minimum standards for the policies and procedures.<sup>26</sup> One of those commenters had previously expressed support for the proposed policies-based approach with minimum requirements,<sup>27</sup> but asserted that the proposed rule text requiring

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<sup>26</sup> SIFMA and WilmerHale Debt.

<sup>27</sup> Letter from Amal Aly, Managing Director and Associate General Counsel, SIFMA, to Marcia E. Asquith, Corporate Secretary, FINRA, dated November 14, 2008 regarding Regulatory Notice 08-55 (Research Analysts and Research Reports).



procedures to “at a minimum, be reasonably designed to prohibit” specified conduct is either superfluous or confusing. Another commenter favored retaining the proscriptive approach in the current equity rules and also requiring that firms maintain policies and procedures designed to ensure compliance.<sup>28</sup> Another commenter supported the types of communications between debt research analysts and other persons that may be permitted by a firm’s policies and procedures.<sup>29</sup> One commenter questioned the necessity of the “preamble” requiring policies and procedures that “restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity” that precedes specific prohibited activities related to investment banking transactions.<sup>30</sup>

One commenter asked FINRA to refrain from using the concept of “reliable” research in the proposal as it may inappropriately connote accuracy in the context of a research analyst’s opinions.<sup>31</sup>

#### 1. Prepublication Review

As proposed, the first of these minimum requirements would require that the policies and procedures must, at a minimum, be reasonably designed to prohibit prepublication review, clearance or approval of debt research by persons involved in investment banking, sales and trading or principal trading, and either restrict or prohibit such review, clearance and approval by other non-research personnel other than legal and compliance.<sup>32</sup> The policies and procedures

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<sup>28</sup> NASAA Debt.

<sup>29</sup> CFA Institute.

<sup>30</sup> WilmerHale Debt.

<sup>31</sup> SIFMA.

<sup>32</sup> See proposed FINRA Rule 2242(b)(2)(A) and (B). FINRA clarified that a firm would be required to specify in its policies and procedures the circumstances, if any, where

also must prohibit prepublication review of a debt research report by a subject company, other than for verification of facts.<sup>33</sup> No specific comments were received on this provision.

## 2. Coverage Decisions

The proposed rule change would require that policies and procedures must restrict or limit input by investment banking, sales and trading and principal trading personnel to ensure that research management independently makes all final decisions regarding the research coverage plan.<sup>34</sup> However, the provision does not preclude personnel from these or any other department from conveying customer interests and coverage needs, so long as final decisions regarding the coverage plan are made by research management.

One commenter asked FINRA to eliminate as redundant the term “independently” from the provisions permitting non-research personnel to have input into research coverage, so long as research management “independently makes all final decisions regarding the research coverage plan.”<sup>35</sup> The commenter asserted that inclusion of “independently” is confusing since the proposal would permit input from non-research personnel into coverage decisions.

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prepublication review would be permitted as necessary and appropriate pursuant to proposed FINRA Rule 2242(b)(2)(B), for example, where non-research personnel are best situated to verify select facts or where administrative personnel review for formatting. FINRA noted that members still would be subject to the overarching requirement to have policies and procedures reasonably designed to effectively manage conflicts of interest between research analysts and those outside of the research department. See also proposed FINRA Rule 2242.05 (Submission of Sections of a Draft Research Report for Factual Review).

<sup>33</sup> See proposed FINRA Rule 2242(b)(2)(N).

<sup>34</sup> See proposed FINRA Rule 2242(b)(2)(C).

<sup>35</sup> WilmerHale Debt.

### 3. Solicitation and Marketing of Investment Banking Transactions

A member's written policies and procedures would also be required, at a minimum, restrict or limit activities by debt research analysts that can reasonably be expected to compromise their objectivity.<sup>36</sup> This would include prohibiting participation in pitches and other solicitations of investment banking services transactions and road shows and other marketing on behalf of issuers related to such transactions. The proposed rule change proposes a Supplementary Material that incorporates an existing FINRA interpretation for the equity research rules that prohibits in pitch materials any information about a member's debt research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable debt research coverage.<sup>37</sup>

The proposed rule change also would prohibit investment banking personnel from directing debt research analysts to engage in sales or marketing efforts related to an investment banking services transaction or any communication with a current or prospective customer about an investment banking services transaction.<sup>38</sup> In addition, the proposed rule change proposes a Supplementary Material to provide that, consistent with this requirement, no debt research analyst may engage in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction.<sup>39</sup>

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<sup>36</sup> See proposed FINRA Rule 2242(b)(2)(L).

<sup>37</sup> See proposed FINRA Rule 2242.01 (Efforts to Solicit Investment Banking Business).

<sup>38</sup> See proposed FINRA Rule 2242(b)(2)(M).

<sup>39</sup> See proposed FINRA Rule 2242.02(a) (Restrictions on Communications with Customers and Internal Personnel).

One commenter asked that FINRA modify the prohibition on debt analyst attendance at road shows to permit passive participation since there is less opportunity to meet and assess issuer management than in the equity context.<sup>40</sup>

#### 4. Supervision

The proposed rule change would require that the policies and procedures prohibit persons engaged in investment banking activities sales and trading or principal trading activities from supervision of debt research analysts.<sup>41</sup> No specific comments were received on this provision.

#### 5. Information Barriers

The proposed rule change would require that the policies and procedures establish information barriers or other institutional safeguards to ensure that debt research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services, principal trading or sales and trading activities or others who might be biased in their judgment or supervision.<sup>42</sup>

Some commenters suggested that “review” was unnecessary in this provision because the review of debt research analysts was addressed sufficiently in other parts of the proposed rule.<sup>43</sup> One commenter further suggested that the terms “review” and “oversight” are redundant.<sup>44</sup> One commenter asked FINRA to clarify that the information barriers or other institutional safeguards

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<sup>40</sup> WilmerHale Debt.

<sup>41</sup> See proposed FINRA Rule 2242(b)(2)(D). FINRA stated that the provision is substantively the same as current NASD Rule 2711(b)(1), which they characterized as a core structural separation requirement in the equity research rules they believe is essential to safeguarding analyst objectivity.

<sup>42</sup> See proposed FINRA Rule 2242(b)(2)(H).

<sup>43</sup> SIFMA and WilmerHale Debt.

<sup>44</sup> WilmerHale Debt.

required by the proposed rule are not intended to prohibit or limit activities that would otherwise be permitted under other provisions of the rule.<sup>45</sup> The commenter also asserted that the terms “bias” and “pressure” are broad and ambiguous on their face and requested that FINRA clarify that for purposes of the information barriers requirement that they are intended to address persons who may try to improperly influence research.<sup>46</sup> As an example, the commenter asked whether a bias would be present if an analyst was pressured to change the format of a research report to comply with the research department’s standard procedures or the firm’s technology specifications. One commenter asked FINRA to modify the information barriers or other institutional safeguards requirement to conform the provision to FINRA’s “reasonably designed” standard for related policies and procedures.<sup>47</sup>

#### 6. Budget and Compensation

A member’s written policies and procedures would also be required to limit the determination of a firm’s debt research department budget to senior management, excluding senior management engaged in investment banking or principal trading activities, and without regard to specific revenues or results derived from investment banking.<sup>48</sup> However, the proposed rule change would expressly permit all persons to provide input to senior management regarding the demand for and quality of debt research, including product trends and customer interests. It further would allow consideration by senior management of a firm’s overall revenues and results in determining the debt research budget and allocation of expenses.

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<sup>45</sup> WilmerHale Debt.

<sup>46</sup> WilmerHale Debt.

<sup>47</sup> WilmerHale Debt.

<sup>48</sup> See proposed FINRA Rule 2242(b)(2)(E).

With respect to compensation determinations, a member's written policies and procedures would be required to prohibit compensation based on specific investment banking services or trading transactions or contributions to a firm's investment banking or principal trading activities and prohibit investment banking and principal trading personnel from input into the compensation of debt research analysts.<sup>49</sup> Further, the firm's written policies and procedures would be required to establish that the compensation of a debt research analyst who is primarily responsible for the substance of a research report be reviewed and approved at least annually by a committee that reports to a member's board of directors or, if the member has no board of directors, a senior executive officer of the member.<sup>50</sup> This committee may not have representation from investment banking personnel or persons engaged in principal trading activities and must consider the enumerated factors when reviewing a debt research analyst's compensation, if applicable.<sup>51</sup>

Neither investment banking personnel nor persons engaged in principal trading activities may give input with respect to the compensation determination for debt research analysts. However, sales and trading personnel may give input to debt research management as part of the evaluation process in order to convey customer feedback, provided that final compensation determinations are made by research management, subject to review and approval by the compensation committee.<sup>52</sup> The committee, which may not have representation from investment

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<sup>49</sup> See proposed FINRA Rule 2242(b)(2)(D) and (F).

<sup>50</sup> See proposed FINRA Rule 2242(b)(2)(G).

<sup>51</sup> These include, for example, the debt research analyst's individual performance, including the analyst's productivity and the quality of the debt research analyst's research. See Notice.

<sup>52</sup> See proposed FINRA Rule 2242(b)(2)(D) and (G).

banking or persons engaged in principal trading activities, must document the basis for each debt research analyst's compensation, including any input from sales and trading personnel.

One commenter requested that the proposal define the terms “principal trading activities,” “principal trading personnel,” and “persons engaged in principal trading activities” to exclude traders who are primarily involved in customer accommodation or customer facilitation trading, such as market makers that trade on a principal basis.<sup>53</sup> The commenter stated that the exclusion is necessary to allow those traders to provide feedback from clients for the purposes of evaluating debt research analysts for compensation determination. More directly to that point, the same commenter and an additional commenter asserted that the proposal should not prohibit those engaged in principal trading activities from providing customer feedback as part of the evaluation and compensation process for a debt research analyst.<sup>54</sup> They contended that the fixed income markets operate primarily on a principal basis and prohibiting such input would have a broad impact on research management's ability to appropriately evaluate and compensate debt research analysts. Another commenter asked for clarification of the term “principal trading” because it believes the term “sales and trading” already encompasses all agency, principal and proprietary trading activities.<sup>55</sup> The debt proposal imposes greater restrictions on interaction between debt research analysts and principal trading personnel than between debt research analysts and sales and trading personnel because the magnitude of the conflict is greater with respect to the former.

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<sup>53</sup> WilmerHale Debt.

<sup>54</sup> SIFMA and WilmerHale Debt.

<sup>55</sup> SIFMA.

## 7. Personal Trading Restrictions

Under the proposed rule change, a member's written policies and procedures would be required to restrict or limit trading by a "debt research analyst account" in securities, derivatives and funds whose performance is materially dependent upon the performance of securities covered by the debt research analyst.<sup>56</sup> The procedures would be required to ensure that those accounts, supervisors of debt research analysts and associated persons with the ability to influence the content of debt research reports do not benefit in their trading from knowledge of the content or timing of debt research reports before the intended recipients of such research have had a reasonable opportunity to act on the information in the report.<sup>57</sup> Furthermore, the procedures would also be required to generally prohibit a debt research analyst account from purchasing or selling any security or any option or derivative of such security in a manner inconsistent with the debt research analyst's most recently published recommendation, except that they may define circumstances of financial hardship (e.g., unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account) in which the firm will permit trading contrary to that recommendation. In determining whether a particular trade is contrary to an existing recommendation, FINRA stated that firms would be permitted to take into account the context of a given trade, including the extent of coverage of the subject security. While the proposed rule change does not include a recordkeeping

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<sup>56</sup> See proposed FINRA Rule 2242(b)(2)(J). See Notice for a description of the term "debt research analyst account."

<sup>57</sup> See proposed FINRA Rule 2242.07 (Ability to Influence the Content of a Research Report) which would provide that for the purposes of the rule, an associated person with the ability to influence the content of a debt research report is an associated person who, in the ordinary course of that person's duties, has the authority to review the debt research report and change that debt research report prior to publication or distribution.



requirement, FINRA stated it expects members to evidence compliance with their policies and procedures and retain any related documentation in accordance with FINRA Rule 4511.

The proposed rule change includes Supplementary Material .10, which would provide that FINRA would not consider a research analyst account to have traded in a manner inconsistent with a research analyst's recommendation where a member has instituted a policy that prohibits any research analyst from holding securities, or options on or derivatives of such securities, of the companies in the research analyst's coverage universe, provided that the member establishes a reasonable plan to liquidate such holdings consistent with the principles in paragraph (b)(2)(J)(i) and such plan is approved by the member's legal or compliance department.<sup>58</sup>

No specific comments were received on this provision.

#### 8. Retaliation and Promises of Favorable Research

The proposed rule change would require that the policies and procedures must prohibit direct or indirect retaliation or threat of retaliation against debt research analysts by any employee of the firm for publishing research or making a public appearance that may adversely affect the member's current or prospective business interests.<sup>59</sup> The policies and procedures would also be required to prohibit explicit or implicit promises of favorable debt research,

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<sup>58</sup> See proposed FINRA Rule 2242.10.

<sup>59</sup> See proposed FINRA Rule 2242(b)(2)(I). This provision is not intended to limit a member's authority to discipline or terminate a debt research analyst, in accordance with the member's written policies and procedures, for any cause other than writing an adverse, negative, or otherwise unfavorable research report or for making similar comments during a public appearance.

specific research content or a specific rating or recommendation as inducement for the receipt of business or compensation.<sup>60</sup> No specific comments were received on these provisions.

9 Joint Due Diligence with Investment Banking Personnel

The proposed rule change would establish a proscription with respect to joint due diligence activities – *i.e.*, due diligence by the debt research analyst in the presence of investment banking department personnel – during a specified time period. Specifically, the proposed rule change states that FINRA would interpret the overarching principle requiring members to, among other things, establish, maintain and enforce written policies and procedures that address the interaction between debt research analysts, banking and subject companies,<sup>61</sup> to prohibit the performance of joint due diligence prior to the selection of underwriters for the investment banking services transaction.<sup>62</sup> No specific comments were received on this provision.

10. Communications Between Debt Research Analysts and Trading Personnel

The proposed rule change would delineate the prohibited and permissible interactions between debt research analysts and sales and trading and principal trading personnel. The proposed rule change would require members to establish, maintain and enforce written policies and procedures reasonably designed to prohibit sales and trading and principal trading personnel from 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.<sup>63</sup> It would further prohibit debt research analysts from identifying or recommending specific potential trading

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<sup>60</sup> See proposed FINRA Rule 2242(b)(2)(K).

<sup>61</sup> See proposed FINRA Rule 2242(b)(1)(C).

<sup>62</sup> See proposed FINRA Rule 2242.09 (Joint Due Diligence).

<sup>63</sup> See proposed FINRA Rule 2242.03(a)(1) (Information Barriers between Research Analysts and Trading Desk Personnel).

transactions to sales and trading or principal trading personnel that are inconsistent with such debt research analyst's currently published debt research reports or from disclosing the timing of, or material investment conclusions in, a pending debt research report.<sup>64</sup>

The proposed rule change would permit sales and trading and principal trading personnel to communicate customers' interests to a debt research analyst, so long as the debt research analyst does not respond by publishing debt research for the purpose of benefiting the trading position of the firm, a customer or a class of customers.<sup>65</sup> The proposed rule change also would permit sales and trading and principal trading personnel to seek the views of debt research analysts regarding the creditworthiness of the issuer of a debt security and other information regarding an issuer of a debt security that is reasonably related to the price or performance of the debt security, so long as, with respect to any covered issuer, such information is consistent with the debt research analyst's published debt research report and consistent in nature with the types of communications that a debt research analyst might have with customers. In determining what is consistent with the debt research analyst's published debt research, a member would be permitted to consider the context, including that the investment objectives or time horizons being discussed differ from those underlying the debt research analyst's published views.<sup>66</sup> Finally, debt research analysts would be permitted to seek information from sales and trading and principal trading personnel regarding a particular debt instrument, current prices, spreads,

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<sup>64</sup> See proposed FINRA Rule 2242.03(a)(2) (Information Barriers between Research Analysts and Trading Desk Personnel).

<sup>65</sup> See proposed FINRA Rule 2242.03(b)(1) (Information Barriers between Research Analysts and Trading Desk Personnel).

<sup>66</sup> See proposed FINRA Rule 2242.03(b)(3) (Information Barriers between Research Analysts and Trading Desk Personnel).

liquidity and similar market information relevant to the debt research analyst's valuation of a particular debt security.<sup>67</sup>

The proposed rule change clarifies that communications between debt research analysts and sales and trading or principal trading personnel that are not related to sales and trading, principal trading or debt research activities would be permitted to take place without restriction, unless otherwise prohibited.<sup>68</sup>

One commenter asked that FINRA clarify that members that have developed policies and procedures consistent with FINRA Rule 5280 (Trading Ahead of Research Reports) would also be in compliance with the debt proposal's expectation of structural separation between investment banking and debt research, and between sales and trading and principal trading and debt research.<sup>69</sup>

The commenter also asked FINRA to delete the term "attempting" in the proposed Supplementary Material .03(a)(1), the provision which would require members to have policies and procedures reasonably designed to prohibit sales and trading and principal trading personnel from "attempting to influence a debt research analyst's opinion or views for the purpose of

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<sup>67</sup> See proposed FINRA Rule 2242.03(b)(4) (Information Barriers between Research Analysts and Trading Desk Personnel).

<sup>68</sup> See proposed FINRA Rule 2242.03(c) (Information Barriers between Research Analysts and Trading Desk Personnel).

<sup>69</sup> WilmerHale Debt. Among other things, Rule 5280 requires members to establish, maintain and enforce policies and procedures reasonably designed to restrict or limit the information flow between research department personnel, or other persons with knowledge of the content or timing of a research report, and trading department personnel, so as to prevent trading department personnel from utilizing non-public advance knowledge of the issuance or content of a research report for the benefit of the member or any other person. See FINRA Rule 5280.

benefitting the trading position of the firm, a customer, or a class of customers.”<sup>70</sup> The commenter stated that it is unclear how a firm should enforce a prohibition on attempts to influence.

The commenter further expressed concern that the term “pending” is vague in the above-cited provision.<sup>71</sup> The commenter suggested that FINRA delete the term or confirm that “pending” means “imminent publication of a debt research report.”

As explained above, Supplementary Material .03(b)(3) provides that in determining what is consistent with a debt research analyst’s published debt research for purposes of sharing certain views with sales and trading and principal trading personnel, members would be permitted to consider the context, including that the investment objectives or time horizons being discussed may differ from those underlying the debt analyst’s published views. One commenter asked FINRA to clarify that the standard may be applied wherever consistency with a debt research analyst’s views may be assessed under the proposed debt rule, such as with respect to debt research analyst account trading or providing customized analysis, recommendations, or trade ideas to sales and trading, principal trading, and customers.<sup>72</sup>

#### 11. Restrictions on Communications with Customers and Internal Sales Personnel

The proposed rule change would apply standards to communications with customers and internal sales personnel. Any written or oral communication by a debt research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction would be required to be fair, balanced and not misleading, taking into consideration

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<sup>70</sup> WilmerHale Debt.

<sup>71</sup> WilmerHale Debt.

<sup>72</sup> WilmerHale Debt.

the overall context in which the communication is made.<sup>73</sup> Consistent with the prohibition on investment banking department personnel directly or indirectly directing a debt research analyst to engage in sales or marketing efforts related to an investment banking services transaction or directing a debt research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction, no debt research analyst would be permitted to engage in any communication with a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction. No specific comments were received on this provision.

C. Content and Disclosure in Research Reports

The proposed rule change would, in general, adopt the disclosures in the equity research rule for debt research, with modifications to reflect the different characteristics of the debt market. The proposed rule change would require members to establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in their debt research reports are based on reliable information.<sup>74</sup> While there is no obligation to employ a rating system under the proposed rule, members that choose to employ a rating system would be required to clearly define in each debt research report the meaning of each rating in the system, including the time horizon and any benchmarks on which a rating is based. In addition, the definition of each rating would be required to be consistent with its plain meaning.<sup>75</sup>

Consistent with the equity rules, irrespective of the rating system a member employs, a member would be required to disclose, in each debt research report that includes a rating, the

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<sup>73</sup> See proposed FINRA Rule 2242.02(b) (Restrictions on Communications with Customers and Internal Personnel).

<sup>74</sup> See proposed FINRA Rule 2242(c)(1)(A).

<sup>75</sup> See proposed FINRA Rule 2242(c)(2).

percentage of all debt securities rated by the member to which the member would assign a “buy,” “hold” or “sell” rating.<sup>76</sup> In addition, a member would be required to disclose in each debt research report the percentage of subject companies within each of the “buy,” “hold” and “sell” categories for which the member has provided investment banking services within the previous 12 months.<sup>77</sup> All such information would be required to be current as of the end of the most recent calendar quarter or the second most recent calendar quarter if the publication date of the debt research report is less than 15 calendar days after the most recent calendar quarter.<sup>78</sup>

If a debt research report contains a rating for a subject company’s debt security and the member has assigned a rating to such debt security for at least one year, the debt research report would be required to show each date on which a member has assigned a rating to the debt security and the rating assigned on such date. This information would be required for the period that the member has assigned any rating to the debt security or for a three-year period, whichever is shorter.<sup>79</sup> Unlike the equity research rules, the proposed rule change would not require those ratings to be plotted on a price chart because of limits on price transparency, including daily closing price information, with respect to many debt securities.

The proposed rule change would require<sup>80</sup> a member to disclose in any debt research report at the time of publication or distribution of the report:

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<sup>76</sup> See proposed FINRA Rule 2242(c)(2)(A).

<sup>77</sup> See proposed FINRA Rule 2242(c)(2)(B).

<sup>78</sup> See proposed FINRA Rule 2242(c)(2)(C).

<sup>79</sup> See proposed FINRA Rule 2242(c)(3).

<sup>80</sup> See proposed FINRA Rule 2242(c)(4).

- if the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, any option, right, warrant, future, long or short position), and the nature of such interest;
- if the debt research analyst has received compensation based upon (among other factors) the member's investment banking, sales and trading or principal trading revenues;
- if the member or any of its affiliates: managed or co-managed a public offering of securities for the subject company in the past 12 months; received compensation for investment banking services from the subject company in the past 12 months; or expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;
- if, as of the end of the month immediately preceding the date of publication or distribution of a debt research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month), the member or its affiliates have received from the subject company any compensation for products or services other than investment banking services in the previous 12 months;<sup>81</sup>
- if the subject company is, or over the 12-month period preceding the date of publication or distribution of the debt research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if

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<sup>81</sup> See also discussion of proposed FINRA Rule 2242.04 (Disclosure of Compensation Received by Affiliates) below.



- applicable, shall be identified as either investment banking services, non-investment banking securities-related services or non-securities services;
- if the member trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report;<sup>82</sup>
  - if the debt research analyst received any compensation from the subject company in the previous 12 months; and
  - 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 the publication or distribution of a debt research report.<sup>83</sup>

The proposed rule change would incorporate a proposed amendment to the corresponding provision in the equity research rules that expands the existing “catch all” disclosure to require disclosure of material conflicts known not only by the research analyst, but also by any “associated person of the member with the ability to influence the content of a research report.” In so doing, the proposed rule change would capture material conflicts of interest that, for example, only a supervisor or the head of research may be aware of. The “reason to know” standard would not impose a duty of inquiry on the debt research analyst or others who can influence the content of a debt research report. Rather, it would cover disclosure of those

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<sup>82</sup> This provision is analogous to the equity research rule requirement to disclose market making activity.

<sup>83</sup> For example, FINRA would consider it to be a material conflict of interest if the debt research analyst or a member of the debt research analyst’s household serves as an officer, director or advisory board member of the subject company.

conflicts that should reasonably be discovered by those persons in the ordinary course of discharging their functions.

The proposed equity research rules include an additional disclosure if the member or its affiliates maintain a significant financial interest in the debt or equity of the subject company, including, at a minimum, if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company. FINRA did not include this provision in the proposed debt research rule because, unlike equity holdings, firms do not typically have systems to track ownership of debt securities.

The proposed rule change would provide that a member would be permitted to satisfy the disclosure requirement with respect to receipt of non-investment banking services compensation by an affiliate by implementing written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the affiliate as to whether the affiliate received such compensation.<sup>84</sup> In addition, a member would be permitted to satisfy the disclosure requirement with respect to the receipt of investment banking compensation from a foreign sovereign by a non-U.S. affiliate of the member by implementing written policies and procedures reasonably designed to prevent the debt research analyst and associated persons of the member with the ability to influence the content of debt research reports from directly or indirectly receiving information from the non-U.S. affiliate as to whether such non-U.S. affiliate received or expects to receive such compensation from the foreign sovereign. However, a member would be required to disclose receipt of compensation by its affiliates from the subject company (including any foreign sovereign) in the past 12

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<sup>84</sup> See proposed FINRA Rule 2242.04 (Disclosure of Compensation Received by Affiliates).

months when the debt research analyst or an associated person with the ability to influence the content of a debt research report has actual knowledge that an affiliate received such compensation during that time period.

The proposed rule change would adopt from the equity research rules the general exception for disclosure that would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.<sup>85</sup> Similar to the equity research rules, the proposed rule change would require that disclosures be presented on the front page of debt research reports or the front page must refer to the page on which the disclosures are found. Electronic debt research reports, however, may provide a hyperlink directly to the required disclosures. All disclosures and references to disclosures required by the proposed rule must be clear, comprehensive and prominent.<sup>86</sup>

Like the equity research rule, the proposed rule change would permit a member that distributes a debt research report covering six or more companies (compendium report) to direct the reader in a clear manner to the applicable disclosures. Electronic compendium reports must include a hyperlink to the required disclosures. Paper-based compendium reports must provide either a toll-free number or a postal address to request the required disclosures and also may include a web address of the member where the disclosures can be found.<sup>87</sup>

One commenter opposed as overbroad the proposed expansion of the current “catch-all” disclosure requirement to include “any other material conflict of interest of the research analyst or member that a research analyst or an associated person of the member with the ability to

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<sup>85</sup> See proposed FINRA Rule 2242(c)(5).

<sup>86</sup> See proposed FINRA Rule 2242(c)(6).

<sup>87</sup> See proposed FINRA Rule 2242(c)(7).

influence the content of a research report knows or has reason to know” at the time of publication or distribution of research report.<sup>88</sup> (emphasis added) The commenter expressed concern about the emphasized language.

One commenter requested confirmation that members may rely on hyperlinked disclosures for research reports that are delivered electronically, even if these reports are subsequently printed out by customers.<sup>89</sup>

One commenter expressed concern about the requirements that a member disclose in retail debt research reports its distribution of all debt security ratings (and the percentage of subject companies in each buy/hold/sell category for which the member has provided investment banking services within the previous 12 months) and historical ratings information on the debt securities that are the subject of the debt research report for a period of three years or the time during which the member has assigned a rating, whichever is shorter.<sup>90</sup> The commenter asked FINRA to eliminate these provisions because they are impractical and provide minimal benefit to investors in the context of debt research, even though they may be very useful in the equity context.<sup>91</sup> The commenter stated that the large number of bond issues followed by analysts make the provisions especially burdensome and do not allow for helpful comparisons for investors across debt securities or issuers. With respect to the ratings distribution requirements, the commenter asserted that in some cases, a debt analyst may assign a rating to the issuer that applies to all of that issuer’s bonds, thereby skewing the distribution because those issuers will

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<sup>88</sup> WilmerHale Debt.

<sup>89</sup> WilmerHale Debt.

<sup>90</sup> WilmerHale Debt.

<sup>91</sup> WilmerHale Debt.

be overrepresented in the distribution. The commenter also stated that the tracking requirements for these provisions would be particularly burdensome, given the numerous bonds issued by the same subject company and the fact that bonds are constantly being replaced with newer ones. Finally, the commenter stated that the three-year look back period is too long and suggested instead a one-year period if FINRA retains the historical rating table requirement.

The same commenter also requested that FINRA allow members to provide a hyperlink or web address to web-based disclosures in all debt research reports, rather than requiring the disclosures within a printed report.<sup>92</sup> The commenter noted that while the Commission has interpreted Section 15D(b) of the Act<sup>93</sup> to require disclosure in each equity report, the law does not apply to debt research.

#### D. Disclosures in Public Appearances

The proposed rule change closely parallels the equity research rules with respect to disclosure in public appearances. Under the proposed rule, a debt research analyst would be required to disclose in public appearances:<sup>94</sup>

- if the debt research analyst or a member of the debt research analyst's household has a financial interest in the debt or equity securities of the subject company (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), and the nature of such interest;

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<sup>92</sup> WilmerHale Debt.

<sup>93</sup> 15 U.S.C. 78o-6(b).

<sup>94</sup> See proposed FINRA Rule 2242(d)(1).

- if, to the extent the debt research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the previous 12 months;
- if the debt research analyst received any compensation from the subject company in the previous 12 months;
- if, to the extent the debt research analyst knows or has reason to know, the subject company currently is, or during the 12-month period preceding the date of publication or distribution of the debt research report, was, a client of the member. In such cases, the debt research analyst also must disclose the types of services provided to the subject company, if known by the debt research analyst; or
- any other material conflict of interest of the debt research analyst or member that the debt research analyst knows or has reason to know at the time of the public appearance.

However, a member or debt research analyst would not be required to make any such disclosure to the extent it would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.<sup>95</sup> Unlike in debt research reports, the “catch all” disclosure requirement in public appearances would apply only to a conflict of interest of the debt research analyst or member that the analyst knows or has reason to know at the time of the public appearance and does not extend to conflicts that an associated person with the ability to influence the content of a research report or public appearance knows or has reason to know.

The proposed rule change would require members to maintain records of public appearances by debt research analysts sufficient to demonstrate compliance by those debt

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<sup>95</sup> See proposed FINRA Rule 2242(d)(2).

research analysts with the applicable disclosure requirements for public appearances. Such records would be required to be maintained for at least three years from the date of the public appearance.<sup>96</sup>

No specific comments were received on this provision not already discussed in connection with the disclosures that would be required in research reports.

E. Disclosure Required by Other Provisions

With respect to both research reports and public appearances, the proposed rule change would require that, in addition to the disclosures required under the proposed rule, members and debt research analysts must comply with all applicable disclosure provisions of FINRA Rule 2210 (Communications with the Public) and the federal securities laws.<sup>97</sup> No specific comments were received on this provision.

F. Distribution of Member Research Reports

The proposed rule change, like the proposed amendments to the equity research rules, would codify an existing interpretation of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) and provides additional guidance regarding selective – or tiered – dissemination of a firm’s debt research reports. The proposed rule change would require firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a debt research report is not distributed selectively to internal trading personnel or a particular customer or class of customers in advance of other customers that the member has previously determined are entitled to receive the debt research report.<sup>98</sup> The proposed rule

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<sup>96</sup> See proposed FINRA Rule 2242(d)(3).

<sup>97</sup> See proposed FINRA Rule 2242(e).

<sup>98</sup> See proposed FINRA Rule 2242(f).

change includes further guidance to explain that firms may provide different debt research products and services to different classes of customers, provided the products are not differentiated based on the timing of receipt of potentially market moving information and the firm discloses its research dissemination practices to all customers that receive a research product.<sup>99</sup>

One commenter supported the provisions as proposed with general disclosure,<sup>100</sup> while another contended that FINRA should require members to disclose when its research products and services do, in fact, contain a recommendation contrary to the research product or service received by other customers.<sup>101</sup> The commenter favoring general disclosure asserted that disclosure of specific instances of contrary recommendations would impose significant burdens unjustified by the investor protection benefits. The commenter stated that a specific disclosure requirement would require close tracking and analysis of every research product or service to determine if a contrary recommendation exists. The commenter further stated that the difficulty of complying with such a requirement would be exacerbated in large firms by the number of research reports published and research analysts employed and the differing audiences for research products and services.<sup>102</sup> The commenter asserted that some firms may publish tens of thousands of research reports each year and employ hundreds of analysts across various disciplines and that a given research analyst or supervisor could not reasonably be expected to know of all other research products and services that may contain differing views.

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<sup>99</sup> See proposed FINRA Rule 2242.06 (Distribution of Member Research Products).

<sup>100</sup> WilmerHale Debt.

<sup>101</sup> PIABA Debt.

<sup>102</sup> WilmerHale Debt.



Another commenter expressed concern that the proposal raises issues about the parity of information received by retail and institutional investors, and whether research provided to institutional investors could contain views that differ from those in research to retail investors.<sup>103</sup>

G. Distribution of Third-party Debt Research Reports

The proposed rule change would incorporate 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 addition, the proposed rule change would adopt an expanded requirement in the proposed equity research rules that requires members to disclose any other material conflict of interest that can reasonably be expected to have influenced the member's choice of a third-party research provider or the subject company of a third-party research report.<sup>104</sup>

No specific comments were received on this provision.

H. Obligations of Persons Associated with a Member

The proposed rule change would clarify the obligations of each associated person under those provisions of the proposed rule that require a member to restrict or prohibit certain conduct by establishing, maintaining and enforcing particular policies and procedures. Specifically, the proposed rule change provides that, consistent with FINRA Rule 0140, persons associated with a member would be required to comply with such member's written policies and procedures as established pursuant to the proposed rule. Failure of an associated person to comply with such policies and procedures would constitute a violation of the proposed rule.<sup>105</sup> In addition,

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<sup>103</sup> CFA Institute.

<sup>104</sup> See Notice for a full explanation of the treatment of third-party and independent third-party debt research reports.

<sup>105</sup> See proposed FINRA Rule 2242.08 (Obligations of Persons Associated with a Member).

consistent with Rule 0140, the proposed rule states in Supplementary Material .08 that it would be a rule violation for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of written policies and procedures required by provisions of FINRA Rule 2242, including applicable Supplementary Material, that embed in the policies and procedures specific obligations on individuals.

Some commenters suggested FINRA eliminate this language in the supplementary material that provides that the failure of an associated person to comply with the firm's policies and procedures constitutes a violation of the proposed rule itself.<sup>106</sup> These commenters argued that because members may establish policies and procedures that go beyond the requirements set forth in the rule, the provision may have the unintended consequence of discouraging firms from creating standards in their policies and procedures that extend beyond the rule. One of those commenters suggested that the remaining language in the supplementary material adequately holds individuals responsible for engaging in restricted or prohibited conduct covered by the proposals.<sup>107</sup>

I. Exemption for Members with Limited Principal Trading Activity or Investment Banking Activity

The proposed rule change would exempt members with limited principal trading activity or limited investment banking activity from the review, supervision, budget, and compensation provisions in the proposed rule related to principal trading and investment banking personnel, respectively.<sup>108</sup> The limited principal trading exemption would apply to firms that engage in principal trading activity where, in absolute value on an annual basis, the member's trading gains

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<sup>106</sup> SIFMA and WilmerHale Debt.

<sup>107</sup> WilmerHale Debt.

<sup>108</sup> See proposed FINRA Rule 2242(h) and (i).

or losses on principal trades in debt securities are \$15 million or less over the previous three years, on average per year, and the member employs fewer than 10 debt traders. The limited investment banking exemption would apply, as it does in the equity rules, to firms that have managed or co-managed 10 or fewer investment banking services transactions on average per year, over the previous three years and generated \$5 million or less in gross investment banking revenues from those transactions.

One commenter questioned whether the exemptions could compromise the independence and accuracy of the analysis and opinions provided.<sup>109</sup> The commenter further expressed concern that the exemption might allow traders to act on debt research prior to publication and distribution of that research. The commenter noted FINRA's commitment to monitor firms that avail themselves of the exemptions to evaluate whether the thresholds for the exemptions are appropriate and asked FINRA to publish findings that could help properly weigh the burdens on small firms while ensuring the independence of investment research. The commenter also encouraged FINRA to provide additional guidance as to what specific measures should be taken to ensure that debt research analysts are insulated from pressure by persons engaged in principal trading or sales and trading activities or other persons who might be biased in their judgment or supervision.

J. Exemption for Debt Research Reports Provided to Institutional Investors

The proposed rule change would exempt debt research provided solely to certain eligible institutional investors from many of the proposed rule's provisions, provided that a member obtains consent from the institutional investor to receive that research and the research reports contain specified disclosure to alert recipients that the reports do not carry the same protections

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<sup>109</sup> CFA Institute.

as retail debt research.<sup>110</sup> The proposal distinguishes between larger and smaller institutions in the manner in which the consent must be obtained. Firms may use negative consent where the customer meets the definition of QIB and satisfies the institutional suitability standards of FINRA Rule 2111 with respect to debt transactions and strategies. Institutional accounts that meet the definition of FINRA Rule 4512(c), but do not satisfy the higher tier standard required for negative consent, may affirmatively elect in writing to receive institutional debt research.

One commenter opposed providing any exemption for debt research distributed solely to eligible institutional investors, contending that it would deprive the market's largest participants of the important protections of the proposed rules for retail debt research.<sup>111</sup> Another commenter reiterated concerns expressed in response to an earlier iteration of the debt research proposal that the proposed standard for negative consent would be difficult to implement and would disadvantage institutional investors who are capable of, and in fact, make independent investment decisions about debt transactions and strategies. The commenter suggested as an alternative that the institutional investor standard should be based on only on the institutional suitability standard in Rule 2111.<sup>112</sup>

Another commenter supported the proposed tiered approach for how institutional investors may receive research reports.<sup>113</sup> The commenter stated that a QIB presumably has the sophistication and human and financial resources to evaluate debt research without the disclosures and other protections that accompany reports provided to retail investors. The commenter also supported permitting an institutional investor that does not fall within the higher

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<sup>110</sup> See proposed FINRA Rule 2242(j).

<sup>111</sup> PIABA Debt.

<sup>112</sup> SIFMA.

<sup>113</sup> CFA Institute.

tier category to receive the debt research without the retail investor protections if it notifies the firm in writing of its election.

Another commenter asked that FINRA confirm that, in distributing debt research reports under the institutional debt research framework to certain non-U.S. institutional investors who are customers of a member's non-U.S. broker-dealer affiliate, the member may rely on similar classifications in the non-U.S. institutional investors' home jurisdictions.<sup>114</sup> The commenter contended that this is necessary because some global firm distribute their debt research reports to non-U.S. institutional investors who may not have been vetted as QIBs for a variety of reasons.

The same commenter asked FINRA to clarify the application of the institutional debt research framework to desk analysts or other personnel who are part of the trading desk and are not "research department" personnel. In particular, the commenter suggested that proposed Rules 2242(b)(2)(H) (with respect to pressuring) and (b)(2)(L) should not apply when sales and trading personnel or principal trading personnel publish debt research reports in reliance on the institutional research exemption because the requirements of those provisions cannot be reconciled with the inherent nature of conflicts present.<sup>115</sup> Those provisions would require firms to have policies and procedures to: (i) establish information barrier or other institutional safeguards reasonably designed to insulate debt research analysts from pressure by, among others, principal trading or sales and trading personnel; and (ii) restrict or limit activities by debt research analyst that can reasonably be expected to compromise their objectivity.

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<sup>114</sup> WilmerHale Debt.

<sup>115</sup> WilmerHale Debt.

K. General Exemptive Authority

The proposed rule change would provide FINRA, pursuant to the FINRA Rule 9600 Series, with authority to conditionally or unconditionally grant, in exceptional and unusual circumstances, an exemption from any requirement of the proposed rule for good cause shown, after taking into account all relevant factors and provided that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.<sup>116</sup> No specific comments were received on this provision.

L. Other General Comments

One commenter asked FINRA to consider amending FINRA Rule 2210 to exclude debt research reports from that rule's filing requirements, since there is an exception from the filing requirements for equity research reports that concern only equity securities that trade on an exchange.<sup>117</sup>

Also, one commenter requested that the implementation date be at least 12 months after SEC approval of the proposed rule change and that FINRA sequence the compliance dates of the equity research filing and the proposed rule change in that order.<sup>118</sup> Another commenter requested that FINRA provide a "grace period" of one year or the maximum time permissible, if that is less than one year, between the adoption of the proposed rule and the implementation date.<sup>119</sup>

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<sup>116</sup> See proposed FINRA Rule 2242(k).

<sup>117</sup> WilmerHale Debt.

<sup>118</sup> SIFMA.

<sup>119</sup> WilmerHale Debt.

### III. Proceedings to Determine Whether to Approve or Disapprove SR-FINRA-2014-048

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposals should be approved or disapproved.<sup>120</sup> Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to comment on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>121</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 15A(b)(9) of the Act,<sup>122</sup> which requires that FINRA's rules be designed to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any others they may have with the proposed rule change. In particular, the Commission invites the written

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<sup>120</sup> 15 U.S.C. 78s(b)(2). Section 19(b)(2)(B) of the Act provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to an additional 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or if the self-regulatory organization consents to the extension.

<sup>121</sup> 15 U.S.C. 78s(b)(2).

<sup>122</sup> 15 U.S.C. 78o-3(b)(6).

views of interested persons concerning whether the proposed rule change is inconsistent with Section 15A(b)(9) or any other provision of the Act, or the rules and regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>123</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule changes should be approved or disapproved by [insert 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2014-048 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

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<sup>123</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).



All submissions should refer to File Number SR-FINRA-2014-048. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal

office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2014-048 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>124</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>124</sup> 17 CFR 200.30-3(a)(57).