SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74488; File No. SR-FINRA-2014-047)

March 12, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 to a Proposed Rule Change to Adopt FINRA Rule 2241 (Research Analysts and Research Reports) in the Consolidated FINRA Rulebook

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" or "Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule to adopt NASD Rule 2711 (Research Analysts and Research Reports) as a FINRA rule, with several modifications; amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 to create an exception from the research analyst qualification requirement; and renumber NASD Rule 2711 as FINRA Rule 2241 in the consolidated FINRA rulebook. The proposal was published for comment in the Federal Register on November 24, 2014.[3] The Commission received four comments on the proposal.[4] On February 19, 2015, FINRA filed Amendment No. 1 responding to the comments received to the proposal as well as to propose amendments in response to these comments. On February 20, 2015, the Commission issued an order instituting proceedings pursuant to Section 19(b)(2)(B) of

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Exchange Act Release No. 73622 (Nov. 18, 2014); 79 FR 69939 (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.

4 See infra note 12.

the Act[5] to determine whether to approve or disapprove the proposal. The order was published for comment in the Federal Register on February 26, 2015.[6]

The proposed rule change, as modified by Amendment No. 1, is described in Items II and III below, which Items have been substantially prepared by FINRA.[7] The Commission is publishing this notice to solicit comments from interested persons on the proposal as amended by Amendment No. 1.

II. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing Amendment No. 1 to SR-FINRA-2014-047, a proposed rule change to adopt NASD Rule 2711 (Research Analysts and Research Reports) as a FINRA rule, with several modifications. The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 to create an exception from the research analyst qualification requirement. The proposed rule change would renumber NASD Rule 2711 as FINRA Rule 2241 in the consolidated FINRA rulebook.

The text of the proposed rule change is available on FINRA's website at http://www.finra.org, at the principal office of FINRA and at the Commission's Public Reference Room.

III. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of

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5 15 U.S.C. 78s(b)(2)(B).

6 Exchange Act Release No. 74339 (Feb. 20, 2015); 80 FR 10528 (Feb. 26, 2015). The comment period closes on March 19, 2015.

7 For a comparison of the changes of the rule text between the proposal as originally noticed and the proposal as amended by Amendment No. 1, see Exhibit 4 to SR-FINRA-2014-047.

and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item V below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule Filing History

On November 14, 2014, FINRA filed with the Securities and Exchange Commission ("Commission") SR-FINRA-2014-047,[8] a proposed rule change to adopt in the consolidated FINRA rulebook ("Consolidated FINRA Rulebook")[9] NASD Rule 2711 (Research Analysts and Research Reports) with several modifications as FINRA Rule 2241.[10] The proposed rule change also would amend NASD Rule 1050 (Registration of Research Analysts) and Incorporated NYSE Rule 344 (Research Analysts and Supervisory Analysts) to create an exception from the research analyst qualification requirements.

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[8] See Securities Exchange Act Release No. 73622 (November 18, 2014), 79 FR 69939 (November 24, 2014) (Notice of Filing File No. SR-FINRA-2014-047) ("Proposing Release"). The comment period closed on December 15, 2014.

[9] The current FINRA rulebook includes, in addition to FINRA Rules, (1) NASD Rules and (2) rules incorporated from NYSE ("Incorporated NYSE Rules") (together, the NASD Rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE ("Dual Members"). For more information about the rulebook consolidation process, see Information Notice, March 12, 2008 (Rulebook Consolidation Process).

[10] On the same date, FINRA also filed a companion proposal to create FINRA Rule 2242 to address conflicts of interest related to the publication and distribution of debt research reports ("debt research proposal"). See Securities Exchange Act Release No. 73623 (November 18, 2014), 79 FR 69905 (November 24, 2014) (Notice of Filing File No. SR-FINRA-2014-048).

The Commission published the proposed rule change for public comment in the Federal Register on November 24, 2014.[11] The Commission received four comment letters directed to the filing.[12] Based on comments received, FINRA is filing this Amendment No. 1 to respond to the comments and to propose amendments, where appropriate. The amendment also includes a few technical, non-substantive changes.

Proposal

As described in greater detail in the Proposing Release, the proposed rule change would retain the core provisions of the current rules, broaden the obligations on members to identify and manage research-related conflicts of interest, restructure the rules to provide some flexibility in compliance without diminishing investor protection, extend protections where gaps have been identified, and provide clarity to the applicability of existing rules. Where consistent with protection of users of research, the proposed rule change reduces burdens where appropriate. The description below is the proposal as amended by Amendment No. 1.[13]

Definitions

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11 See Securities Exchange Act Release No. 73622 (November 18, 2014), 79 FR 69939 (November 24, 2014) (Notice of Filing File No. SR-FINRA-2014-047).

12 See Letter from Hugh D. Berkson, Executive Vice President and President-Elect, Public Investors Arbitration Bar Association, to Brent J. Fields, Secretary, SEC, dated December 15, 2014 ("PIABA Equity"); Letter from Kevin Zambrowicz, Associate General Counsel and Managing Director, and Sean Davy, Managing Director, Securities Industry and Financial Markets Association, to Brent J. Fields, Secretary, SEC, dated December 15, 2014 ("SIFMA"); Letter from Stephanie R. Nicolas, Wilmer Cutler Pickering Hale and Dorr LLP, to Brent J. Fields, Secretary, SEC, dated December 16, 2014 ("WilmerHale Equity"); and Letter from William Beatty, President, North American Securities Administrators Association, Inc., to Brent J. Fields, Secretary, SEC, dated December 19, 2014 ("NASAA Equity").

13 See Notice for a description of the original proposal. See also Exhibit 4 to SR-FINRA-2014-047 for a comparison of changes made in the rule text in Amendment No. 1.

FINRA is proposing to mostly maintain the definitions in current NASD Rule 2711, with the following modifications:

- minor changes to the definition of "investment banking services" to clarify that such services include all acts in furtherance of a public or private offering on behalf of an issuer.[14]
- clarification in the definition of "research analyst account" that the definition does not apply to a registered investment company over which a research analyst or member of the research analyst's household has discretion or control, provided that the research analyst or member of the research analyst's household has no financial interest in the investment company, other than a performance or management fee.[15]
- exclusion from the definition of "research report" of communications concerning open-end registered investment companies that are not listed or traded on an exchange ("mutual funds").[16]
- exclusion from the definition of "research report" of communications that constitute private placement memoranda and comparable offering-related

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[14] See proposed FINRA Rule 2241(a)(5). The current definition includes, without limitation, many common types of investment banking services. FINRA is proposing 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.

[15] See proposed FINRA Rule 2241(a)(9).

[16] See proposed FINRA Rule 2241(a)(11).

documents prepared in connection with investment banking services transactions, other than those that purport to be research. [17]

- move into the definitional section the definitions of "third-party research report" and "independent third-party research report" that are now in a separate provision of the rule.[18]
- adoption of a definition of "sales and trading personnel" to include persons in any department or division, whether or not identified as such, who perform any sales or trading service on behalf of a member.[19]

Identifying and Managing Conflicts of Interest

FINRA is proposing to create a new section entitled "Identifying and Managing Conflicts of Interest." This section contains an overarching provision that requires 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 research reports and public appearances by research analysts and the interaction between research analysts and persons outside of the research department, including investment banking and sales and trading personnel, the subject companies and customers.[20] The written policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research or research

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17 See proposed FINRA Rule 2241(a)(11)(D).

18 See proposed FINRA Rules 2241(a)(3) and (14). FINRA believes it creates a more streamlined and user friendly rule to combine defined terms in a single definitional section.

19 See proposed FINRA Rule 2241(a)(12).

20 See proposed FINRA Rule 2241(b)(1).

analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers.[21] These provisions, therefore, 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 research products and services.

Prepublication Review

FINRA is proposing that the required policies and procedures must prohibit prepublication review, clearance or approval of research reports by persons engaged in investment banking services activities and restrict or prohibit such review, clearance or approval by other persons not directly responsible for the preparation, content and distribution of research reports, other than legal and compliance personnel.[22]

Coverage Decisions

The proposed rule change would require that the policies and procedures restrict or limit input by the investment banking department into research coverage decisions to ensure that research management independently makes all final decisions regarding the research coverage plan.[23]

Supervision and Control of Research Analysts

The proposed rule change would require that the policies and procedures prohibit persons engaged in investment banking activities from supervision or control of research analysts,

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21 See proposed FINRA Rule 2241(b)(2).

22 See proposed FINRA Rule 2241(b)(2)(A).

23 See proposed FINRA Rule 2241(b)(2)(B).

including influence or control over research analyst compensation evaluation and determination.[24]

Research Budget Determinations

The proposed rule change would require that the policies and procedures limit determination of the research department budget to senior management, excluding senior management engaged in investment banking services activities.[25]

Compensation

The proposed rule change would require that the policies and procedures prohibit compensation based upon specific investment banking services transactions or contributions to a member's investment banking services activities.[26] The policies and procedures further must require a committee that reports to the member's board of directors – or if none exists, a senior executive officer – to review and approve at least annually the compensation of any research analyst who is primarily responsible for preparation of the substance of a research report. The committee may not have representation from a member's investment banking department. The committee must consider, among other things, the productivity of the research analyst and the quality of his or her research and must document the basis for each research analyst's compensation.[27] These provisions are consistent with the requirements in current Rule 2711(d).

Information Barriers

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[24] See proposed FINRA Rule 2241(b)(2)(C).

[25] See proposed FINRA Rule 2241(b)(2)(D).

[26] See proposed FINRA Rule 2241(b)(2)(E).

[27] See proposed FINRA Rule 2241(b)(2)(F).

The proposed rule change would require that the policies and procedures establish information barriers or other institutional safeguards reasonably designed to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading personnel, who might be biased in their judgment or supervision.[28]

Retaliation

The proposed rule change would require that the policies and procedures prohibit direct or indirect retaliation or threat of retaliation against research analysts employed by the member or its affiliates by persons engaged in investment banking services activities or other employees as the result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective business interests.[29]

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[28] See proposed FINRA Rule 2241(b)(2)(G).

[29] See proposed FINRA Rule 2241(b)(2)(H).

Quiet Periods

The proposed rule change would require that the policies and procedures define quiet periods of a minimum of 10 days after an initial public offering ("IPO"), and a minimum of three days after a secondary offering, during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer if the member has participated as an underwriter or dealer in the IPO or, with respect to the quiet periods after a secondary offering, acted as a manager or co-manager of that offering.[30]

With respect to these quiet-period provisions, the proposed rule change reduces the current 40-day quiet period for IPOs to a minimum of 10 days after the completion of the offering for any member that participated as an underwriter or dealer, and reduces the 10-day secondary offering quiet period to a minimum of three days after the completion of the offering for any member that has acted as a manager or co-manager in the secondary offering. The proposed rule change maintains exceptions to the quiet periods for research reports or public appearances concerning the effects of significant news or a significant event on the subject company and, for secondary offerings, research reports or public appearances pursuant to SEC Rule 139 regarding a subject company with "actively-traded securities."

The proposed rule change also eliminates the current quiet periods 15 days before and after the expiration, waiver or termination of a lock-up agreement.

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[30] See proposed FINRA Rule 2241(b)(2)(I). Consistent with the Jumpstart Our Business Startups Act ("JOBS Act"), those quiet periods do not apply following the IPO or secondary offering of an Emerging Growth Company ("EGC"), as that term is defined in Section 3(a)(80) of the Exchange Act.

Solicitation and Marketing

In addition, the proposed rule change requires firms to adopt written policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity.[31] This includes the existing prohibitions on 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. FINRA notes that consistent with existing guidance analysts may listen to or view a live webcast of a transaction-related road show or other widely attended presentation by investment banking to investors or the sales force from a remote location, or another room if they are in the same location.[32]

The proposed rule change also adds Supplementary Material .01, which codifies the existing interpretation that the solicitation provision prohibits members from including in pitch materials any information about a member's research capacity in a manner that suggests, directly or indirectly, that the member might provide favorable research coverage.[33]

Joint Due Diligence and Other Interactions with Investment Banking

The proposed rule establishes a new proscription with respect to joint due diligence activities – i.e., due diligence by the research analyst in the presence of investment banking department personnel – during a specified time period. Specifically, proposed Supplementary Material .02 states that FINRA interprets the overarching principle requiring members to, among other things, establish, maintain and enforce written policies and procedures that address the interaction between research analysts and those outside of the research department, including

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31 See proposed FINRA Rule 2241(b)(2)(L).

32 See NASD Notice to Members 07-04 (January 2007) and NYSE Information Memo 07-11 (January 2007).

33 See proposed FINRA Rule 2241.01 and Notice to Members 07-04 (January 2007).

investment banking and sales and trading personnel, subject companies and customers, to prohibit the performance of joint due diligence prior to the selection of underwriters for the investment banking services transaction.

The proposed rule continues to prohibit investment banking department personnel from directly or indirectly directing a research analyst to engage in sales or marketing efforts related to an investment banking services transaction, and directing a research analyst to engage in any communication with a current or prospective customer about an investment banking services transaction.[34] Supplementary Material .03 clarifies that three-way meetings between research analysts and a current or prospective customer in the presence of investment banking department personnel or company management about an investment banking services transaction are prohibited by this provision.[35] FINRA believes that the presence of investment bankers or issuer management could compromise a research analyst's candor when talking to a current or prospective customer about a deal. Supplementary Material .03 also retains the current requirement that any written or oral communication by a research analyst with a current or prospective customer or internal personnel related to an investment banking services transaction must be fair, balanced and not misleading, taking into consideration the overall context in which the communication is made.

Promises of Favorable Research and Prepublication Review by Subject Company

FINRA is proposing to maintain the current prohibition against promises of favorable research, a particular research recommendation, rating or specific content as inducement for

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34 See proposed FINRA Rule 2241(b)(2)(M).

35 See proposed FINRA Rule 2241.03.

receipt of business or compensation.[36] The proposed rule further requires policies and procedures to prohibit prepublication review of a research report by a subject company for purposes other than verification of facts.[37] Supplementary Material .05 maintains the current guidance applicable to the prepublication submission of a research report to a subject company. Specifically, sections of a draft research report may be provided to non-investment banking personnel or the subject company for factual review, provided that: (1) the draft sections do not contain the research summary, research rating or price target; (2) a complete draft of the report is provided to legal or compliance personnel before sections are submitted to non-investment banking personnel or the subject company; and (3) any subsequent proposed changes to the rating or price target are accompanied by a written justification to legal or compliance and receive written authorization for the change. The member also must retain copies of any draft and the final version of the report for three years.[38]

Personal Trading Restrictions

FINRA is proposing to require that firms establish written policies and procedures that restrict or limit research analyst account trading in securities, any derivatives of such securities and funds whose performance is materially dependent upon the performance of securities covered by the research analyst.[39] Such policies and procedures must ensure that research analyst accounts, supervisors of research analysts and associated persons with the ability to influence the content of research reports do not benefit in their trading from knowledge of the

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36 See proposed FINRA Rule 2241(b)(2)(K).

37 See proposed FINRA Rule 2241(b)(2)(N).

38 See proposed FINRA Rule 2241.05.

39 See proposed FINRA Rule 2241(b)(2)(J).

content or timing of a research report before the intended recipients of such research have had a reasonable opportunity to act on the information in the research report.[40] The proposal maintains the current prohibitions on research analysts receiving pre-IPO shares in the sector they cover and trading against their most recent recommendations. However, members may define financial hardship circumstances, if any, in which a research analyst would be permitted to trade against his or her most recent recommendation.[41] The proposed rule change includes Supplementary Material .10, which provides 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.[42]

Content and Disclosure in Research Reports

With a couple of modifications, the proposed rule change maintains the current disclosure requirements. The proposed rule change adds a requirement that a member must establish, maintain and enforce written policies and procedures reasonably designed to ensure that purported facts in its research reports are based on reliable information.[43] FINRA has included this provision because it believes members should have policies and procedures to foster

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40 See proposed FINRA Rule 2241(b)(2)(J)(i).

41 See proposed FINRA Rule 2241(b)(2)(J)(ii).

42 See proposed FINRA Rule 2241.10.

43 See proposed FINRA Rule 2241(c)(1)(A).

verification of facts and trustworthy research on which investors may rely. The policies and procedures also must be reasonably designed to ensure that any recommendation, rating or price target has a reasonable basis and is accompanied by a clear explanation of any valuation method used and a fair presentation of the risks that may impede achievement of the recommendation, rating or price target.[44]

In addition, the proposed rule change would require a member to disclose in any research report at the time of publication or distribution of the report:[45]

- if the research analyst or a member of the 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;[46]
- if the research analyst has received compensation based upon (among other factors) the member's investment banking revenues;[47]
- if the member or any of its affiliates: (i) managed or co-managed a public offering of securities for the subject company in the past 12 months; (ii) received compensation for investment banking services from the subject company in the past 12 months; or (iii) expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months;[48]

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44 See proposed FINRA Rule 2241(c)(1)(B).

45 See proposed FINRA Rule 2241(c)(4).

46 See proposed FINRA Rule 2241(c)(4)(A).

47 See proposed FINRA Rule 2241(c)(4)(B).

48 See proposed FINRA Rule 2241(c)(4)(C).

- if, as of the end of the month immediately preceding the date of publication or distribution of a research report (or the end of the second most recent month if the publication or distribution 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;[49]
- if the subject company is, or over the 12-month period preceding the date of publication or distribution of the research report has been, a client of the member, and if so, the types of services provided to the issuer. Such services, if applicable, must be identified as either investment banking services, non-investment banking services, non-investment banking securities-related services or non-securities services;[50]
- if the member was making a market in the securities of the subject company at the time of publication or distribution of the research report;[51] and
- if the research analyst received any compensation from the subject company in the previous 12 months.[52]

The proposed rule change would also expand upon the current "catch-all" disclosure, which mandates disclosure of any other material conflict of interest of the research analyst or member that the research analyst knows or has reason to know of at the time of the publication or distribution of a research report. The proposed rule change goes beyond the existing provision

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49 See proposed FINRA Rule 2241(c)(4)(D).

50 See proposed FINRA Rule 2241(c)(4)(E).

51 See proposed FINRA Rule 2241(c)(4)(G).

52 See proposed FINRA Rule 2241(c)(4)(H).

by requiring 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."[53] The proposed rule change defines a person with the "ability to influence the content of a research report" as an associated person who is required to review the content of the research report or has exercised authority to review or change the research report prior to publication or distribution. This term does not include legal or compliance personnel who may review a research report for compliance purposes but are not authorized to dictate a particular recommendation, rating or price target.[54] The "reason to know" standard in this provision would not impose a duty of inquiry on the research analyst or others who can influence the content of a research report. Rather, it would cover disclosure of those conflicts that should reasonably be discovered by those persons in the ordinary course of discharging their functions.

The proposed rule change also maintains the requirement to disclose when a member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company.[55] The determination of beneficial ownership would continue to be based upon the standards used to compute ownership for the purposes of the reporting requirements under Section 13(d) of the Exchange Act.

The proposal modifies the exception for disclosure that would reveal material non-public information regarding specific potential future investment banking transactions of the subject company to include specific potential future investment banking transactions of other companies,

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53 See proposed FINRA Rule 2241(c)(4)(I).

54 See proposed FINRA Rule 2241.08.

55 See proposed FINRA Rule 2241(c)(4)(F).

such as a competitor of the subject company.[56] The proposal also continues to permit a member that distributes a research report covering six or more companies (compendium report) to direct the reader in a clear manner as to where the applicable disclosures can be found. An electronic compendium research report may hyperlink to the disclosures. A paper compendium report must include a toll-free number or a postal address where the reader may request the disclosures. In addition, paper compendium reports may include a web address where the disclosures can be found.[57]

Disclosures in Public Appearances

The proposal groups in a separate provision the disclosures required when a research analyst makes a public appearance.[58] The required disclosures remain substantively the same as under the current rules[59] including if the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company, as computed in accordance with Section 13(d) of the Exchange Act. Unlike in research reports, the "catch all" disclosure requirement in public appearances applies only to a conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of the public appearance. FINRA understands that supervisors or legal and compliance personnel, who otherwise might be captured by the definition of an associated person "with the ability to influence," typically do not have the opportunity to review and insist on changes to public appearances, many of which are extemporaneous in nature. The proposal also retains the current

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56 See proposed FINRA Rule 2241(c)(5).

57 See proposed FINRA Rule 2241(c)(7).

58 See proposed FINRA Rule 2241(d).

59 See NASD Rules 2711(h)(1), (h)(2)(B) and (C), (h)(3) and (h)(9).

requirement in NASD Rule 2711(h)(12) to maintain records of public appearances sufficient to demonstrate compliance by research analysts with the applicable disclosure requirements.[60]

Disclosure Required by Other Provisions

With respect to both research reports and public appearances, members and research analysts would continue to be required to comply with applicable disclosure provisions of FINRA Rule 2210 and the federal securities laws.[61]

Termination of Coverage

The proposed rule change retains with non-substantive modifications the provision in the current rules that requires a member to notify its customers if it intends to terminate coverage of a subject company.[62] Such notification must be made promptly[63] using the member's ordinary means to disseminate research reports on the subject company to its various customers. Unless impracticable, the notice must be accompanied by a final research report, comparable in scope and detail to prior research reports, and include a final recommendation or rating. If impracticable to provide a final research report, recommendation or rating, a firm must disclose to its customers the reason for terminating coverage.

Distribution of Member Research Reports

The proposal requires firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a research report is not distributed selectively to

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60 See proposed FINRA Rule 2241(d)(3).

61 See proposed FINRA Rule 2241(e).

62 See proposed FINRA Rule 2241(f).

63 While current Rule 2711(f)(6) does not contain the word "promptly," FINRA has interpreted the provision to require prompt notification of termination of coverage of a subject company.

internal trading personnel or a particular customer or class of customers in advance of other customers that the firm has previously determined are entitled to receive the research report.[64] The proposal includes further guidance to explain that firms may provide different 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.[65]

Distribution of Third-Party Research Reports

The proposal would maintain the existing third-party disclosure requirements,[66] incorporating the change to the "catch-all" provision to include material conflicts of interest that an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the distribution of the third-party research report. In addition, the proposed rule change would require 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.[67]

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64 See proposed FINRA Rule 2241(g).

65 See proposed FINRA Rule 2241.07.

66 NASD Rule 2711(h)(13)(A) currently requires the distributing member firm to disclose the following, if applicable: (1) if the member owns 1% or more of any class of equity securities of the subject company; (2) if the member or any affiliate has managed or co-managed a public offering of securities of the subject company or 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 such services in the next three months; (3) if the member makes a market in the subject company's securities; and (4) any other actual, material conflict of interest of the research analyst or member of which the research analyst knows or has reason to know at the time the research report is distributed or made available.

67 See proposed FINRA Rule 2241(h)(4).

In addition, the proposal continues to address qualitative aspects of third-party research reports. For example, the proposal maintains, but in the form of policies and procedures, the existing requirement that a registered principal or supervisory analyst review and approve third-party research reports distributed by a member. To that end, the proposed rule change requires a member to establish, maintain and enforce written policies and procedures reasonably designed to ensure that any third-party research it distributes contains no untrue statement of material fact and is otherwise not false or misleading. For the purpose of this requirement, a member's obligation to review a third-party research report extends to any untrue statement of material fact or any false or misleading information that should be known from reading the research report or is known based on information otherwise possessed by the member.[68] The proposal further prohibits a member from distributing third-party research if it knows or has reason to know that such research is not objective or reliable.[69]

The proposal maintains the existing exceptions for "independent third-party research reports." Specifically, such research does not require principal pre-approval or, where the third-party research is not "pushed out," the third-party disclosures.[70] As to the latter, a member will not be considered to have distributed independent third-party research where the research is made available by the member: (a) upon request; (b) through a member-maintained website; or (c) to a customer in connection with a solicited order in which the registered representative has informed the customer, during the solicitation, of the availability of independent research on the solicited equity security and the customer requests such independent research.

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68 See proposed FINRA Rules 2241(h)(1) and (h)(3).

69 See proposed FINRA Rule 2241(h)(2).

70 See proposed FINRA Rule 2241(h)(5) and (6).

Finally, under the proposed rule change, members also must ensure that a third-party 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 research report.[71]

Exemption for Firms with Limited Investment Banking Activity

The current rule exempts firms with limited investment banking activity – those that over the previous three years, on average per year, have managed or co-managed 10 or fewer investment banking transactions and generated $5 million or less in gross revenues from those transactions – from the provisions that prohibit a research analyst from being subject to the supervision or control of an investment banking department employee because the potential conflicts with investment banking are minimal.[72] However, those firms remain subject to the provision that requires the compensation of a research analyst to be reviewed and approved annually by a committee that reports to a member's board of directors, or a senior executive officer if the member has no board of directors.[73] That provision further prohibits representation on the committee by investment banking department personnel and requires the committee to consider the following factors when reviewing a research analyst's compensation: (1) the research analyst's individual performance, including the research analyst's productivity and the quality of research; (2) the correlation between the research analyst's recommendations and the performance of the recommended securities; and (3) the overall ratings received from clients, the sales force and peers independent of investment banking, and other independent ratings

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71 See proposed FINRA Rule 2241(h)(7).

72 See NASD Rule 2711(k).

73 See NASD Rule 2711(d)(2).

services.[74] The proposed rule change extends the exemption for firms with limited investment banking activity so that such firms would not be subject to the compensation committee provision. The proposal still prohibits these firms from compensating a research analyst based upon specific investment banking services transactions or contributions to a member's investment banking services activities.[75]

The proposed rule change further exempts firms with limited investment banking activity from the provisions restricting or limiting research coverage decisions and budget determination. In addition, the proposal exempts eligible firms from the requirement to establish information barriers or other institutional safeguards to insulate research analysts from the review or oversight by investment banking personnel or other persons, including sales and trading personnel, who may be biased in their judgment or supervision. However, those firms still are required to establish information barriers or other institutional safeguards reasonably designed to ensure that research analysts are insulated from pressure by investment banking and other non-research personnel who might be biased in their judgment or supervision.

Exemption from Registration Requirements for Certain "Research Analysts"

The proposed rule change amends the definition of "research analyst" for the purposes of the registration and qualification requirements to limit the scope to persons who produce "research reports" and whose primary job function is to provide investment research (e.g., registered representatives or traders generally would not be included).[76] The revised definition is not intended to carve out anyone for whom the preparation of research is a significant component

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74 See NASD Rule 2711(d) and (k).

75 See proposed FINRA Rules 2241(b)(2)(E) and (i).

76 See proposed NASD Rule 1050(b) and proposed Incorporated NYSE Rule 344.10.

of their job; rather, it is intended to provide relief for those who produce research reports on an occasional basis. The existing research rules, in accordance with the mandates of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), are constructed such that the author of a communication that meets the definition of a "research report" is a "research analyst," irrespective of his or her title or primary job.

Attestation Requirement

The proposed rule change would delete the requirement to attest annually that the firm has in place written supervisory policies and procedures reasonably designed to achieve compliance with the applicable provisions of the rules, including the compensation committee review provision.

Obligations of Persons Associated with a Member

Proposed Supplementary Material .09 would clarify the obligations of each associated person under those provisions of the proposed rule change that require a member to restrict or prohibit certain conduct by establishing, maintaining and enforcing particular written policies and procedures. Specifically, the proposal provides that, consistent with FINRA Rule 0140, persons associated with a member must comply with such member's policies and procedures as established pursuant to proposed FINRA Rule 2241.[77] In addition, consistent with Rule 0140, Supplementary Material .09 states that it shall be a violation of proposed Rule 2241 for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by Rule 2241, including applicable Supplementary Material.

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[77] See proposed FINRA Rule 2241.09. FINRA Rule 0140(a), among other things, provides that persons associated with a member shall have the same duties and obligations as a member under the Rules.

General Exemptive Authority

The proposed rule change would provide FINRA, pursuant to the 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.[78]

Response to Comments

In connection with Amendment No. 1, FINRA also responded to the comments received on the original proposal as proposed in the Notice, included below.

General Support

Three of the four commenters to the proposal expressed general support for the proposal.[79]

Definitions and Terms

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."[80] 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 (e.g., the head of equity capital markets);

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78 See proposed FINRA Rule 2241(j).

79 SIFMA, WilmerHale Equity and PIABA Equity.

80 WilmerHale Equity. For consistency with the debt research proposal, FINRA also proposes to amend the proposed rule change to use the term "sales and trading personnel."

or (2) persons who occasionally function in a sales and trading capacity. FINRA intends for the sales and trading personnel conflict management provisions to apply to individuals who perform sales and trading functions, irrespective of their job title or the frequency of engaging in the activities. As such, FINRA does not intend for the rule to capture as sales and trading personnel senior management, such as the chief executive officer, who do not engage in or supervise day-to-day sales and trading activities. However, FINRA believes the applicable provisions should apply to individuals who may occasionally perform or directly supervise sales and trading activities; otherwise, investors could be put at risk with respect to the research or transactions involved when those individuals are functioning in those capacities because the conflict management procedures and proscriptions and required disclosures would not apply. Therefore, FINRA has proposed to amend the rule to define sales and trading personnel to include "persons in any department or division, whether or not identified as such, who perform any sales or trading service on behalf of a member." FINRA notes that this proposed definition is more consistent with the definition of "investment banking department" in the current and proposed rules.

One commenter asked FINRA to include an exclusion from the definition of "research report" for private placement memoranda and similar offering-related documents prepared in connection with investment banking services transactions.[81] 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)

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81 WilmerHale Equity.

excludes communications that constitute statutory prospectuses that are filed as part of a registration statement and contended that the basis for that exception should apply equally to private placement memoranda and similar offering-related documents.

The definition of "research report" is generally understood not to include such offering-related documents prepared in connection with investment banking services transactions. In the course of administering the filing review programs under FINRA Rules 2210 (Communications with the Public), 5110 (Corporate Financing Rule), 5122 (Member Private Offerings) and 5123 (Private Placements of Securities), FINRA has not received any inquiries or addressed any issues that indicate there is confusion regarding the scope of the research analyst rules as applied to offering-related documents prepared in connection with investment banking activities. Nonetheless, to provide firms with greater clarity as to the status of such offering-related documents under the proposal, FINRA proposes to amend the proposed rule change to exclude private placement memoranda and similar offering-related documents prepared in connection with investment banking services transactions other than those that purport to be research from the definition of "research report."

One commenter asked FINRA to refrain from using the concept of "reliable" research in the proposals as it may inappropriately connote accuracy in the context of a research analyst's opinions.[82] However, another commenter supported the requirement to have policies and procedures reasonably designed to ensure that research reports are based on reliable information.[83] As discussed in detail in Item 5 of the Proposing Release, FINRA believes that the term "reliable" is commonly understood and notes that the term is used in certain research-

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82 SIFMA.

83 NASAA.

related provisions in Sarbanes–Oxley without definition. FINRA does not believe the term connotes accuracy of opinions.

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."[84] The commenter asserted that inclusion of "independently" is confusing since the proposal would permit input from non-research personnel into coverage decisions. FINRA has included "independently" to make clear that research management alone is vested with making final coverage decisions. Thus, for example, a firm could not have a committee that includes a majority of research management personnel but also other individuals make final coverage decisions by a vote. As such, FINRA declines to eliminate the term as suggested.

Policies and Procedures

The rule proposal would adopt a policies and procedures approach to identification and management of research-related conflicts of interest and require those policies and procedures to 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.[85] One of those commenters had previously expressed support for the proposed policies-based

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84 WilmerHale Equity.

85 SIFMA and WilmerHale Equity.

approach with minimum requirements,[86] but asserted that the proposed rule text requiring procedures to "at a minimum, be reasonably designed to prohibit" specified conduct is either superfluous or confusing. Another commenter opposed a shift to a policies and procedures scheme "without also maintaining the proscriptive nature of the current rules." The commenter therefore favored retaining the proscriptive approach in the current rules and also requiring that firms maintain policies and procedures designed to ensure compliance.[87] 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.[88] Finally, some commenters suggested FINRA eliminate 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.[89] 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

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86 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).

87 NASAA Equity.

88 WilmerHale Equity.

89 SIFMA and WilmerHale Equity.

material adequately holds individuals responsible for engaging in restricted or prohibited conduct covered by the proposals.[90]

As discussed in more detail in the Proposing Release, FINRA believes the framework will maintain the same level of investor protection in the current rules while providing both some flexibility for firms to align their compliance systems with their business model and philosophy and imposing additional obligations to proactively identify and manage emerging conflicts. Even under a policies and procedures approach, the proposals would effectively maintain, with some modifications, the key proscriptions in the current rules – e.g., prohibitions on prepublication review, supervision of research analysts by investment banking and participation in pitches and road shows. FINRA disagrees that the "preamble" to some of those prohibitions is unnecessary. As with the more general overarching principles-based requirement to identify and manage conflicts of interest, the introductory principle that requires written policies and procedures to restrict or limit activities by research analysts that can reasonably be expected to compromise their objectivity recognizes that FINRA cannot identify every conflict related to research at every firm and therefore requires proactive monitoring and management of those conflicts. FINRA does not believe this "preamble" language is redundant with the broader overarching principle because it applies more specifically to the activities of research analysts and, unlike the broader principle, would preclude the use of disclosure as a means of conflict management for those activities.

In light of the overarching principle that requires firms to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage research-related conflicts, the "at a minimum" language was meant to convey that additional conflicts

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[90] WilmerHale Equity.

management policies and procedures may be needed to address emerging conflicts that may arise as the result of business changes, such as new research products, affiliations or distribution methods at a particular firm. As discussed in the Proposing Release, FINRA intends for firms to proactively identify and manage those conflicts with appropriately designed policies and procedures. FINRA's inclusion of the "at a minimum" language was not intended to suggest that firms' written policies and procedures must go beyond the specified prohibitions and restrictions in the proposal where no new conflicts have been identified. However, FINRA believes the overarching requirement for policies and procedures reasonably designed to identify and effectively manage research-related conflicts suffices to achieve the intended regulatory objective, and therefore to eliminate any confusion, FINRA proposes to amend the proposal to delete the "at a minimum" language.

FINRA appreciates the commenters' concerns with respect to language in the supplementary material that would make a violation of a firm's policies a violation of the underlying rule. The supplementary material was intended to hold individuals responsible for engaging in the conduct that the policies and procedures effectively restrict or prohibit. FINRA agrees that purpose is achieved with the language in the supplementary material that states that, consistent with FINRA Rule 0140, "it shall be a violation of [the Rule] for an associated person to engage in the restricted or prohibited conduct to be addressed through the establishment, maintenance and enforcement of policies and procedures required by [the Rule] or related Supplementary Material." Therefore, FINRA proposes to amend the proposed rule change to delete the language stating that a violation of a firm's policies and procedures shall constitute a violation of the rule itself.

Information Barriers

The proposed rule would require written policies and procedures to "establish information barriers or other institutional safeguards reasonably designed to ensure that research analysts are insulated from the review, pressure or oversight by persons engaged in investment banking services activities or other persons, including sales and trading department personnel, who might be biased in their judgment or supervision." Some commenters suggested that "review" was unnecessary in this provision because the review of research analysts was addressed sufficiently in other parts of the proposed rule.[91] One commenter further suggested that the terms "review" and "oversight" are redundant.[92] FINRA does not agree that the terms "review" and "oversight" are coextensive, as the former may connote informal evaluation, while the latter may signify more formal supervision or authority. And while other provisions of the proposed rule change may address related conduct – e.g., the provision that prohibits investment banking personnel from supervision or control of research analysts – this provision extends to "other persons" who may be biased in their judgment or supervision. Finally, FINRA notes that "review, pressure or oversight" mirrors language in Sarbanes-Oxley. Accordingly, FINRA declines to revise the proposed rule.

One commenter asked FINRA to clarify that the information barriers or other institutional safeguards required by the proposed rule are not intended to prohibit or limit activities that would otherwise be permitted under other provisions of the rule.[93] That was clearly FINRA's intent, and FINRA believes that the rules of statutory construction would compel that result.

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91 SIFMA and WilmerHale Equity.

92 WilmerHale Equity.

93 WilmerHale Equity.

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.[94] 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. FINRA believes the terms "pressure" and "bias" are commonly understood, particularly in the context of rules intended to promote analyst independence and objectivity. To that end, FINRA notes that the terms appear in certain research-related provisions of Sarbanes–Oxley without definition. Thus, with respect to the commenter's example, FINRA does not believe a bias would be present simply because someone insists that a research analyst comply with formatting or technology specifications that do not otherwise implicate the rules.

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 policies and procedures that members must adopt.[95] FINRA believes the change would be consistent with the standard for policies and procedures elsewhere in the proposals, and therefore proposes to amend the provision as requested.

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 influence the content of a research report knows or has reason to know" at the time of

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94 WilmerHale Equity.

95 WilmerHale Equity.

publication or distribution of research report.[96] (emphasis added) The commenter expressed concern about the emphasized language. Another commenter supported the proposed expansion of the current "catch-all" disclosure requirement.[97]

FINRA proposed the change to capture material conflicts of interest known by persons other than the research analyst (e.g., a supervisor or the head of research) who are in a position to improperly influence a research report. FINRA defined "ability to influence the content of a research report" in supplementary material as "an associated person who, in the ordinary course of that person's duties, has the authority to review the research report and change that research report prior to publication or distribution." The commenter stated that the proposed change could capture individuals (especially legal and compliance personnel) who might be required to disclose confidential information that is not covered by the exception in the proposals that would not require disclosure where it would "reveal material non-public information regarding specific potential future investment banking transactions of the subject company." This is because, according to the commenter, legal and compliance may be aware of material conflicts of interest relating to the subject company that involve material non-public information regarding specific future investment banking transactions of a competitor of the subject company. The commenter also expressed concern the provision would slow down dissemination of research to canvass all research supervisors and management for conflicts. The commenter suggested that the change was unnecessary given other objectivity safeguards in the proposals that would guard against improper influence.

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96 WilmerHale Equity.

97 NASAA Equity.

FINRA continues to believe that a potential gap exists in the current rules where a supervisor or other person with the authority to change the content of a research report knows of a material conflict. However, FINRA intended for the provision to capture only those individuals who are required to review the content of a particular research report or have exercised their authority to review or change the research report prior to publication or distribution. In addition, FINRA did not intend to capture legal or compliance personnel who may review a research report for compliance purposes but are not authorized to dictate a particular recommendation, rating or price target. FINRA proposes to amend the supplementary material in the proposals consistent with this clarification. In addition, FINRA proposes to modify the exception in proposed Rules 2241(c)(5) and (d)(2) (applying to public appearances) not to require disclosure that would otherwise reveal material non-public information regarding specific potential future investment banking transactions, whether or not the transaction involves the subject company.

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.[98] As long as a research report delivered electronically contains a hyperlink directly to the required disclosures, the standard will be satisfied.

Research Products with Differing Recommendations

The proposal requires firms to establish, maintain and enforce written policies and procedures reasonably designed to ensure that a 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 firm has previously determined are entitled to receive the research report. The

[98] WilmerHale Equity.

proposals also include supplementary material that explains that firms may provide different research products to different classes of customers – e.g., long term fundamental research to all customers and short-term trading research to certain institutional customers – provided the products are not differentiated based on the timing of receipt of potentially market moving information and the firm discloses, if applicable, that one product may contain a different recommendation or rating from another product.

One commenter supported the provisions as proposed with general disclosure,[99] while another contended that FINRA should require members to disclose when their research products and services do, in fact, contain a recommendation contrary to the research product or service received by other customers.[100] 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.[101] They 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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99 WilmerHale Equity.

100 PIABA Equity.

101 WilmerHale Equity.

Importantly, the supplementary material states that products may lead to different recommendations or ratings, provided that each is consistent with the member's ratings system for each respective product. In other words, all differing recommendations or ratings must be reconcilable such that they are not truly at odds with one another. Since the proposals would not allow inconsistent recommendations that could mislead one or more investors, FINRA believes general disclosure of alternative products with different objectives and recommendations is appropriate relative to its investor protection benefits.

Quiet Periods

The proposal would eliminate or reduce the quiet periods during which a member may not publish or otherwise distribute research reports or make a public appearance following its participation in an offering. Citing recent enforcement actions in the research area, one commenter did not support elimination or reduction of the quiet periods.[102] As discussed in more detail in Item 3 of the Proposing Release, FINRA believes that the separation, disclosure and certification requirements in the current rules and Regulation AC have had greater impact on the objectivity of research than maintaining quiet periods during which research may not be distributed and research analysts may not make public appearances. FINRA noted that there is a cost to investors when they are deprived of information and analysis during quiet periods. FINRA believes that the proposed changes to the quiet periods would promote information flow to investors without jeopardizing the objectivity of research. FINRA also notes that the enforcement actions cited by the commenter that favors retaining the existing quiet periods did not involve the quiet period provisions of the rules, nor in FINRA's view would maintaining the current quiet periods have deterred the conduct in those cases.

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[102] NASAA Equity.

Other commenters requested that FINRA retain the exceptions in NASD Rule 2711(f) that permits: (i) the publication and distribution of research or a public appearance concerning the effects of significant news or a significant event on the subject company during the quiet period; and (ii) the publication of distribution of research pursuant to Rule 139 under the Securities Act of 1933.[103] FINRA agrees that those exceptions should be included and therefore proposes to amend the proposed rule change accordingly.

Disclosure Requirements

Two commenters opposed the requirement in the equity proposal that members disclose, in an equity research report, if they or their affiliates maintain a significant financial interest in the debt of the research company.[104] The commenters noted that the debt research analyst proposal does not contain a dedicated requirement to disclose significant debt holdings; rather, it relies on the "catch-all" provision, which would require disclosure of a firm's debt holdings of a subject company only where it rises to an actual material conflict of interest. The commenters asserted that the reasoning in the debt proposal – e.g., that firms do not have systems to track ownership of debt securities and that the number and complexity of bonds and the fact that a firm may be both long and short different bonds of the same issuer makes real-time disclosure of credit exposure difficult – applies equally to equity research. Another commenter supported the requirement in the equity proposal that members disclose, in an equity research report, if they or their affiliates maintain a significant financial interest in the debt of the research company.[105] One commenter also stated that while FINRA correctly noted that the United Kingdom's

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103 SIFMA, WilmerHale Equity.

104 SIFMA, WilmerHale Equity.

105 NASAA Equity.

Financial Conduct Authority rules require disclosure of debt holdings in equity research reports, that requirement is more akin to the "catch-all" provision because the disclosure is limited to circumstances where the holdings "may reasonably be expected to impair the objectivity of research recommendations" or "are significant in relation to the research recommendations." FINRA believes that amending the equity proposal to the treat disclosure of debt holdings consistent with the debt proposal would promote consistency and efficiency while maintaining the same level of investor protection. Therefore, FINRA proposes to amend the proposed rule change accordingly, including modifying a similar disclosure requirement when making public appearances.

Impact on Global Settlement

One commenter asked FINRA to confirm in any Regulatory Notice announcing adoption of the proposed rule change that provisions relating to research coverage and budget decisions and joint due diligence are intended to supersede the corresponding terms of the Global Research Analyst Settlement ("Global Settlement").[106] As discussed in the 2012 United States Government Accountability Office ("GAO") Report on Securities Research,[107] FINRA does not believe that the terms of the Global Settlement should be modified through FINRA rulemaking and instead should be determined by the court overseeing the enforcement action. Therefore, FINRA does not intend for any provisions of the equity proposal that may be adopted to supersede provisions of the Global Settlement.

Exemptive Authority

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106 WilmerHale Equity.

107 GAO, Securities Research, Additional Actions Could Improve Regulatory Oversight of Analyst Conflicts of Interest, January 2012.

One commenter opposed the provision that would give FINRA the authority to grant, in exceptional or unusual circumstances, an exemption from the requirement of the proposed rule for good cause shown.[108] The commenter stated that the provision had not been sufficiently justified by, among other things, providing examples of where an exemption would be justified. The purpose of exemptive authority is to provide a mechanism of relief in unusual factual circumstances that cannot be foreseen, where application of the rule would frustrate or be inconsistent with its intended purposes. As such, it is difficult if not impossible for FINRA to provide examples of where it would be appropriate to use the authority. However, as FINRA stated in the equity proposal rule filing, the scope of the rule's subject matter and the diversity of firm sizes, structures and research business and distribution models make it more likely that factual circumstances may arise that had not been contemplated by the rule. In addition, the authority is limited not only to exceptional circumstances, but also to a showing of good cause.

Implementation Date

One commenter requested that the implementation date be at least 12 months after SEC approval of the proposed rule change.[109] Another commenter similarly 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.[110] FINRA is sensitive to the time firms will require to update their policies and procedures and systems to comply with the proposal and will take those factors into consideration when establishing implementation dates.

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108 NASAA Equity.

109 SIFMA.

110 WilmerHale Equity.

FINRA believes that the foregoing fully responds to the issues raised by the commenters.

FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 180 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[111] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. FINRA believes the proposed rule change protects investors and the public interest by maintaining, and in some cases expanding, structural safeguards to insulate research analysts from influences and pressures that could compromise the objectivity of research reports and public appearances on which investors rely to make investment decisions. FINRA further believes that the proposed rule change prevents fraudulent and manipulative acts and practices by requiring firms to identify and manage, often with extensive disclosure, conflicts of interest related to the preparation, content and distribution of research. At the same time, the proposal furthers the public interest by increasing information flow to investors in select circumstances – e.g., before and after the expiration of lock up provisions – where FINRA believes the integrity of research will not be compromised.

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111 15 U.S.C. 78o-3(b)(6).

Moreover, the proposed rule change is consistent with Section 15D of the Act,[112] which requires rules reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public appearances. The proposed rule change requires firms to establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with the provisions of Section 15D, including: restricting prepublication clearance or approval of research reports by investment banking personnel or other persons not directly responsible for the preparation, content and distribution of research reports; prohibiting persons engaged in investment banking activities from supervision or control of research analysts, including influence or control over research analyst compensation evaluation and determination; prohibiting retaliation or threat of retaliation against research analysts for research or public appearances that are unfavorable to the member's business interests; establishing quiet periods after public offerings during which members that have participated in the offering may not publish or otherwise distribute research; and establishing structural or institutional safeguards to protect analysts from the review, pressure or oversight of investment bankers or other non-research personnel that might be biased in their judgment or supervision. In addition, the proposed rule change requires disclosures consistent with Section 15D, including the requirement to disclose any material conflict of interest of the research analyst or member that the research analyst knows or has reason to know at the time of publication or distribution of a research report or during a public appearance.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the

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112 15 U.S.C. 78o-6.

Act. FINRA provided a comprehensive statement regarding the burden on competition in the Proposing Release. FINRA's response to comments and proposed revisions as set forth in this Amendment No. 1 do not change FINRA's statement in the Proposing Release.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were solicited by the Commission in response to the publication of SR-FINRA-2014-047.[113] The Commission received four comment letters, which are summarized above.

IV. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 180 days after the date of publication of the initial notice in the Federal Register (i.e., November 24, 2014) or within such longer period up to an additional 60 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will issue an order approving or disapproving such proposed rule change, as amended.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:[114]

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

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113 See Proposing Release, supra note 3.

114 See supra note 6.

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2014-047 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.

All submissions should refer to File Number SR-FINRA-2014-047. 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-2014-047 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.[115]

Brent J. Fields
Secretary

[115] 17 CFR 200.30-3(a)(12).